

# FIDUCIARY TRAINING PART II: LITIGATION TRENDS AND TAKEAWAYS

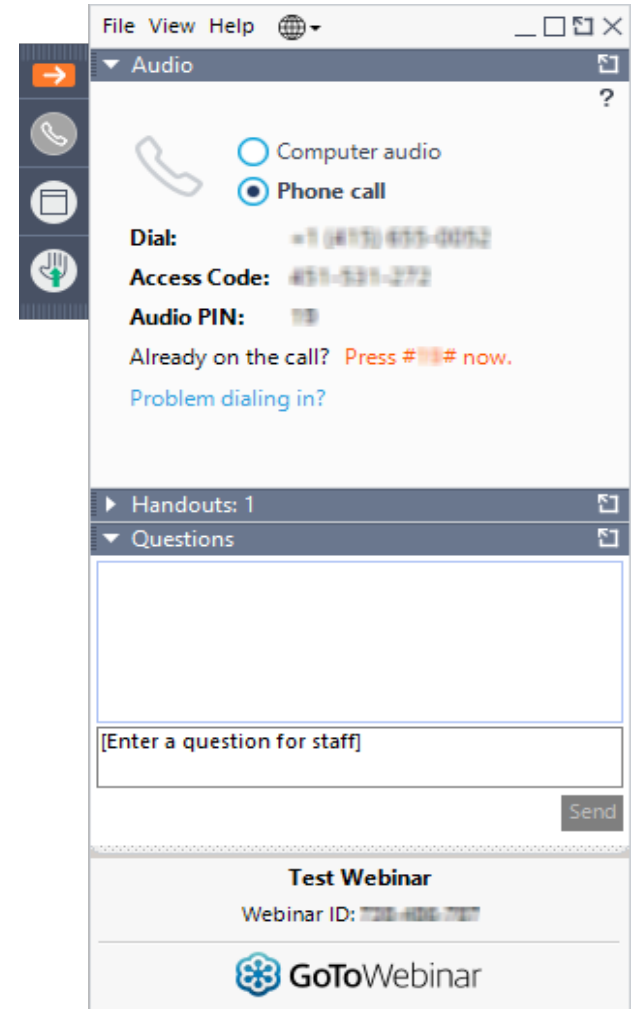
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May 2023



# INFORMATION ABOUT TODAY'S SESSION

- Select “Phone call” to dial in.
- All attendee lines are automatically muted.
- Questions can be asked by typing them into the questions pane on the control panel, and there will be time at the end of the session to answer questions.
- Submitted questions will not be visible to other audience members.
- Today’s session is being recorded.







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# **KEY THEMES AND DEVELOPMENTS AND HOW FIDUCIARIES CAN MITIGATE RISK**

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# OVERVIEW

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- The Employee Retirement Income Security Act of 1974 (ERISA) is the federal law that governs private sector retirement plans.
- ERISA imposes stringent fiduciary standards on parties who manage and administer plans, including as to administrative fees (recordkeeping) and selection of investment options in participant-directed defined contribution plans.
- ERISA also gives plan participants and beneficiaries a right to sue for breaches of fiduciary duty.
- A significant plaintiffs' bar has developed to bring ERISA breach of fiduciary claims as class actions over the last 10 to 15 years.
- The volume of ERISA litigation has skyrocketed in the past few years.



# AGENDA

01

## Fee and Expense Litigation

- Themes and Developments
- Plan Sponsor Takeaways

02

## Investment Selection and Monitoring Litigation

- Themes and Developments
- Plan Sponsor Takeaways

03

## Emerging Issues in Plan-Related Cybersecurity

04

## Emerging Issues in the Use of Participant Data





# **FEE AND EXPENSE LITIGATION**

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# FEE AND EXPENSE LITIGATION: LANDSCAPE

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- The steady stream of ERISA fee and expense lawsuits has turned into a deluge over the last few years.
- The challenges have moved downstream, no longer targeting only huge plans.
- The core claims are similar, but the theories of fiduciary breach have evolved as courts, plan sponsors, and the market react.
- Most fees and expenses actions assert several common challenges:
  - Excessive administrative/recordkeeping fees (including challenges to revenue sharing)
  - Failure to move to lower-cost share classes of the same fund
  - Failure to use lower-cost vehicles (e.g., CITs or separately managed accounts)



# FEE AND EXPENSE LITIGATION: LANDSCAPE

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A motion to dismiss (MTD) is a key battleground in ERISA class actions. Few cases have reached trial—and even fewer have resulted in judgments for plaintiffs.

- If a plaintiff can survive the MTD, it means full-scale litigation, including class wide discovery, depositions, etc.
- This imposes disproportionate burdens on defendants and can create settlement leverage for plaintiffs, who know it will be expensive to get to the next *off-ramp* at a motion for summary judgment or trial.



# FEE AND EXPENSE LITIGATION: LANDSCAPE

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## *Hughes v. Northwestern University: SCOTUS weighs in*

- Northwestern was one of many universities sued under ERISA since 2016.
- The cases involved similar theories: “excessive” investment and recordkeeping fees and offered poor investment options, among other claims.
- The Seventh Circuit affirmed full dismissal on MTD.
- The Supreme Court takes the case... Narrow ruling.
  - No *per se* rules: Diverse investment menu is not a categorical defense to allegations that certain plan fees or expenses are individually imprudent.
  - But the Supreme Court says courts should give “due regard” to the “range of reasonable judgments a fiduciary may make based on her experience and expertise.”

# FEE AND EXPENSE LITIGATION: LANDSCAPE

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## *Hughes v. Northwestern University: Take Two in the Seventh Circuit*

- In March 2023, the Seventh Circuit issued a further opinion in the case on remand.
- Court revived recordkeeping-fee and share-class claims.
  - Heavy focus on alleged failure to consolidate multiple recordkeepers.
  - Court recognized there can be reasonable and prudent reasons that fiduciaries might not offer lowest-cost share class, but believed those were issues for discovery.
- Case now heads back to the trial court.

# FEE AND EXPENSE LITIGATION: LANDSCAPE

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## Individual Investment Fee Claims

- Plaintiffs' approach:
  - Focus on handful of investments in the menu (usually actively managed)
  - Build chart alleging that fiduciaries should have replaced those investment options with allegedly “comparable” cheaper options (usually passively managed)
  - Failure to offer less-expensive investment options equals imprudence
- Courts for the most part are rejecting these claims at MTD stage.
  - Comparisons between active and passive are inapt. This is the same with different types of investment vehicles (e.g., mutual funds vs. CITs).
  - Fiduciaries need not prioritize cost above all else.



# FEE AND EXPENSE LITIGATION: LANDSCAPE

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## Recordkeeping-Fee Claims

- Plaintiffs' approach:
  - Plaintiffs purport to calculate plan's recordkeeping fees, usually with 5500 data (often wrong).
  - Plaintiffs build chart comparing fees to other plans that paid less, which equals imprudence.
  - Courts are increasingly skeptical about these claims, but many still survive MTDs.
- Some key issues:
  - Recordkeeping services equals commodity
  - Apples-to-oranges comparisons
  - Bald assertions of no competitive bidding/RFP for recordkeepers
  - Multiple recordkeepers and alleged failure to leverage bargaining power
- Going beyond recordkeepers? Other service providers?

# FEE AND EXPENSE LITIGATION: LANDSCAPE

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## Share-Class Claims

- Plaintiffs' approach:
  - Plaintiffs find group of investments that were not in the lowest-cost share class for at least some of the relevant period (ERISA's 6-year lookback)
  - Based on this fact alone, assert fiduciary breach because of claim that investments were identical except for cost.
- These claims have almost universally survived MTDs.
  - Easier theory for courts to grasp – comparators are “baked in” to the claims.
  - Courts generally acknowledge there can be reasonable and prudent reasons fiduciaries might elect different share classes, but punt on those questions until discovery.
  - “Revenue sharing” rationale.

# FEE AND EXPENSE LITIGATION: PLAN SPONSOR TAKEAWAYS

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- The two ERISA fiduciary duties most commonly at issue in litigation are the [duty of prudence](#) and the [duty of loyalty](#).
- [The duty of loyalty](#) requires a fiduciary to discharge his or her duties with respect to a plan:
  - Solely in the interest of the participants and beneficiaries
  - For the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan
- The interests of the participants and beneficiaries must come before any other interests—including the interests of the plan sponsor or the interests of any plan service provider.

# FEE AND EXPENSE LITIGATION: PLAN SPONSOR TAKEAWAYS

- The **duty of prudence** requires a fiduciary to discharge his or her duties with respect to a plan:
  - “With the care, skill, prudence, and diligence then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”
- Sometimes referred to as “procedural prudence”
- Highlights the importance of documenting fiduciary considerations and decision
  - The most prudent process in the world will not help if you cannot demonstrate it.
- Basically—Fiduciary *Good Housekeeping*



Image Source: Good Housekeeping "Vintage Good Housekeeping magazine covers" (October 16, 2014)



# FEE AND EXPENSE LITIGATION: PLAN SPONSOR TAKEAWAYS

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- Develop and follow a process for evaluating and monitoring fees.
  - Conduct periodic RFPs to evaluate competitiveness of existing fees.
  - In addition to full-fledged RFPs, consider a process for less formal, more frequent review and benchmarking of fees.
  - Fully understand the fees being paid and the services being provided—this can be half the battle.
- Confirm that your participant fee disclosures are accurate and timely.
- Leverage your advisors to help with reviewing fees—both for RFPs and for more informal and more frequent reviews—and for documenting your review.



# **INVESTMENT SELECTION AND MONITORING LITIGATION**

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# INVESTMENT SELECTION AND MONITORING LITIGATION

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- Along with fee-related claims, many lawsuits assert imprudence based on investment underperformance and broader “suitability” arguments.
  - Plaintiffs find group of investments with periods of alleged underperformance against some benchmark or alternative investment(s)
  - Usually based on lookback of investment returns; sometimes other metrics
  - Often coupled with fee-based challenges to same investment(s)
- Key issues:
  - Hindsight analysis
  - Appropriateness of performance comparisons – benchmarks, investable alternatives
  - Limited track record; market outlier?
  - Proprietary funds; other disloyalty-adjacent allegations

# INVESTMENT SELECTION AND MONITORING LITIGATION

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## Target-Date Fund (TDF) Litigation:

- In the past few years, plaintiffs have deployed this theory on different TDF suites.
  - Big targets: TDFs are oftentimes the largest share of assets within plans.
  - TDFs are frequently the Qualified Default Investment Alternative (QDIA) in plans.
- Fidelity Freedom Funds
  - Wave of cases across the country focused on excessive fees and relative underperformance
  - Some courts allowed claims to proceed
  - Some courts dismissed claims at MTD
  - *Smith v. CommonSpirit Health* – Sixth Circuit 2022
- Other TDFs targeted, too, including “custom” TDFs.



# INVESTMENT SELECTION AND MONITORING LITIGATION

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## Target-Date Fund (TDF) Litigation:

- BlackRock LifePath TDFs.
  - July/August 2022, the same plaintiffs' firm filed virtually identical lawsuits against 11 large retirement plans that offered BlackRock TDFs.
  - Plaintiffs admit BlackRock TDFs are low fee.
  - Theory is unusually narrow. Underperformance alone = imprudence.
  - Cause for guarded optimism? Three cases dismissed with prejudice so far at MTD.
- Considerations:
  - Glidepath: through retirement vs. to retirement.
  - Active vs. passive investment strategy.

# INVESTMENT SELECTION AND MONITORING LITIGATION: PLAN SPONSOR TAKEAWAYS

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- Leverage support and expertise of investment consultants.
- Consider special review of TDFs
  - There are more moving pieces in TDFs than other investment options.
    - Levels of fees
    - Appropriately assessing performance
  - TDFs can represent a very large percentage of plan assets.
  - We expect more litigation and regulatory focus on TDFs in the coming years.
- Memorialize decision-making in committee minutes.
- Role of an investment policy statement:
  - If you have one, review it periodically against current investment offerings.
  - Beware of overly specific investment policy statements.



# **EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY**

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# EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY

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- DOL guidance and audit activity has made it clear that in its view, securing ERISA plan participants' account balances and personally identifiable information (PII) is a fiduciary responsibility
- In situations where plan participants are adversely impacted by a security breach—e.g., where their defined contribution plan accounts are accessed by a bad actor and their funds withdrawn—participants may seek redress against plan fiduciaries for failing to prevent the breach.
- Courts are just beginning to explore the parameters of those fiduciaries' responsibilities.

# EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY

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## Plan-Related Cybersecurity Litigation

- *Disberry v. Employee Relations Committee of the Colgate-Palmolive Company et al*, (S.D.N.Y. Dec. 19, 2022)
  - Participant's \$750,000 401(k) plan account was embezzled by someone fraudulently claiming to be the participant.
  - Participant sued the plan fiduciary committee and the plan's recordkeeper.
  - Court would not grant the plan fiduciary and recordkeeper a motion to dismiss because the court found that the plaintiff:
    - Plausibly argued that the recordkeeper was a fiduciary and ignored red flags
    - Plausibly argued that the plan fiduciary failed to prudently monitor the recordkeeper
- More cases can be expected in the future, as fraudsters identify large plan balances as tempting targets for cyber-theft.

# EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY

## What is the DOL asking about?

- Senior DOL official: “I don't think they would be surprised by the kinds of questions they would get from our investigators” based on the guidance.
- DOL requests have covered categories like:
  - Policies and procedures
  - Assessments and audit reports
  - Technical controls and practices
  - Insurance coverage
  - Prior cybersecurity events and responses

## What can the DOL do? What is the risk?

- At a minimum, the DOL can subject plans to long (multi-year) and resource-taxing investigations.
- At worst, the DOL can make findings of fiduciary breach.
  - Although breach findings are probably more likely only if the DOL is investigating after a breach incident.
- But it is too early to predict where the DOL is going.



# DOL GUIDANCE: TIPS FOR HIRING SERVICE PROVIDERS



## Guidance to Plan Sponsors:

Here are six tips for plan fiduciaries when hiring a service provider; largely focused on hiring recordkeepers and custodians/trustees.

- 1 Ask about the service provider's data security standards, practices, policies, and audit results, and benchmark those against industry standards.
- 2 Analyze the service provider's security standards and security validation practices.
- 3 Evaluate the service provider's track record in the industry.
- 4 Ask about past security events and responses.
- 5 Confirm that the service provider has adequate insurance coverage for losses related to cybersecurity and identity theft events.
- 6 Ensure that the services agreement between the plan fiduciary and the service provider includes provisions requiring ongoing compliance with cybersecurity standards.

# EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY

## Basic (Possible) Proactive Steps for Fiduciaries

- Review the DOL guidance and consider following the steps in the DOL guidance.
- Consider a checklist evaluation that incorporates recent DOL guidance.
- Evaluate insurance policies.
- Discuss cybersecurity with plan service providers.
- Discuss cybersecurity with internal IT resources.

## Enhanced (Possible) Proactive Steps for Fiduciaries

- Consider an enhanced self-assessment, such as:
  - Review provider contracts.
  - Review internal data security protections.
  - Conduct internal trainings on cybersecurity for plan staff and plan participants.
  - Review plan documents and communications.
  - Create a cybersecurity policy.

# EMERGING ISSUES IN PLAN-RELATED CYBERSECURITY

And don't forget the easy stuff—like not having your login information hanging on the wall when you invite the media in for a photo op.

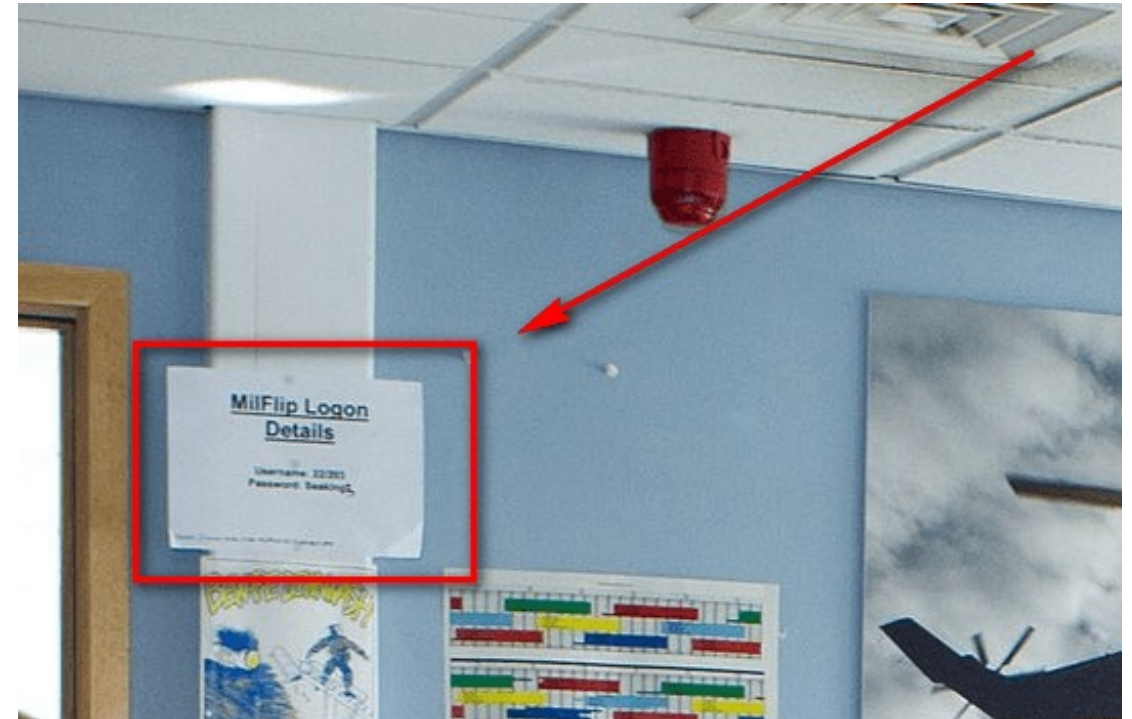
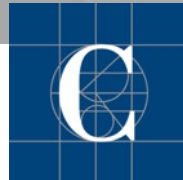


Image Source: DotTech "Lesson in password security: Photo of UK's Prince William reveals password for Royal Air Force login" (November 27, 2012)



# **EMERGING ISSUES IN THE USE OF PARTICIPANT DATA**

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# EMERGING ISSUES IN THE USE OF PARTICIPANT DATA

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- There are a number of thorny legal issues relating to the ability of plan sponsors and fiduciaries to share plan or participant data.
  - Is plan data a plan asset?
  - Who must consent to sharing participant data?
  - Is it permissible for plan service providers to use participant data to sell participants non-plan services?
  - Disclosure issues
- You may wish to consider discussions with your service providers about how they use participant data.

# EMERGING ISSUES IN THE USE OF PARTICIPANT DATA

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Circumstances where plan and participant data may be used by recordkeepers:

- Using information in a customer-interaction software program that is shared with the recordkeeper's affiliates
- Using participant data to solicit the purchase of non-plan retail financial products and services
- Deriving revenue from the use of data by third parties



# EMERGING ISSUES IN THE USE OF PARTICIPANT DATA

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- ERISA Litigation Risks
  - Plaintiffs have filed cases alleging that plan fiduciaries breached their ERISA fiduciary duties by allowing recordkeepers/administrators to use plan data for cross-selling.
  - Plaintiffs allege that data used for cross-selling is a plan asset and therefore the data must be used in the best interest of participants.
  - A number of settlements have been conditioned on limiting vendor use of data.
- Courts thus far have not been receptive to the idea of participant data as a plan asset.
- But we may continue to see litigation and regulatory focus in this area.
- Fiduciaries should ask appropriate questions and understand how data is used.



# QUESTIONS

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THANK YOU

# DISCLOSURE

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