

# Current Developments in Fiduciary Litigation

## Item 7 – Deferred Compensation Board

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Office of Legal Services



# Informational item only

- No Board action is required.

# Legal Foundation for Fiduciary Duties

Common Law of Trusts

Federal Employee Retirement Income Security Act (ERISA)

Wisconsin State Law:

- Uniform Fiduciaries Act, Chapter 112
- Uniform Prudent Investor Act, Chapter 881

Most breach of fiduciary duty cases are brought against ERISA-covered plans alleging violations of the duty of prudence

# Trends in Retirement Plan Fiduciary Litigation



Excessive record-keeping fees



Active funds with lower investment performance than passive funds



Target date fund investment performance lower than other investment options



Failure to regularly solicit competitive bids



Unreasonable investment fees

# Recent Fiduciary Litigation Cases

# U.S. Supreme Court Decision

- ***Hughes v. Northwestern University***. The United States Supreme Court issued a decision on January 24, 2022, with respect to whether Northwestern may have breached its fiduciary duty to its 403(b) plan participants in three ways:
  1. failing to monitor and control recordkeeping fees;
  2. offering mutual funds and annuities in the form of “retail” share classes that carried higher fees than those charged by otherwise identical share classes of the same investments; and
  3. offering options that were likely to confuse participants.
- The 7<sup>th</sup> Circuit Court of Appeals previously affirmed the dismissal of the suit because participants had the freedom to choose between low-cost and more expensive investment options. The U.S. Supreme Court disagreed.

## Key Takeaway:

**Fiduciaries have a duty to prudently select and monitor all investments on a defined contribution plan menu.** The U.S. Supreme Court concluded that failure to remove imprudent investments within a reasonable time is a violation of fiduciary duty.

# *Albert v. Oshkosh Corp.*

- Participants brought breach of fiduciary duty claims against Oshkosh Corp.'s 401(k) plan, including excessive record-keeping fees, failing to ensure investment options were prudent, and unreasonably maintaining high-cost investment advisors. The 7th Circuit Court of Appeals affirmed dismissal of all the claims.

## Key Takeaways:

- 1. Choosing the cheapest option is not required.** In the decision, the 7th Circuit reiterated its position that fiduciaries do not need to choose the cheapest option, whether for recordkeeping fees or investment options.
- 2. Fiduciaries are not required to regularly solicit quotes or competitive bids, but must review whether fees are reasonable:** In addressing the prudence claim in relation to record-keeping fees, the court rejected the argument that failing to regularly solicit quotes or competitive bids was a breach of fiduciary duty.

# *Matousek v. MidAmerican Energy Co.*

- Participants alleged MidAmerican Energy Co. breached its fiduciary duty by paying excessive recordkeeping and administrative fees and offering poor-performing or high-cost investment options.

## Key Takeaway:

**Breach of fiduciary duty claims on cost or investment performance must be evaluated against meaningful comparators.** The 8th Circuit Court of Appeals affirmed dismissal as participants did not provide any meaningful benchmarks for comparing recordkeeping costs, administrative fees, investment fees or investment performance. Industry-wide averages and raw performance data for other investments was not sufficient.



# *Vellali v. Yale University*

- Plan participants in Yale University's 403(b) plan alleged Yale violated its fiduciary duty of prudence by offering too many investment options, delaying consolidation to a single recordkeeper, failing to obtain competitive bids, and failing to prohibit TIAA from cross-selling resulting in losses to the plan. The case has been set for trial.

## Key Takeaways:

- 1. A decision that takes five years may not be prudent.** Waiting five years to consolidate from two recordkeepers to a single recordkeeper may not be prudent.
- 2. Check Plan policies and federal guidance:** While ERISA doesn't require fiduciaries to engage in competitive bids, Yale's policies did. Plus, the U.S. Department of Labor recommends fiduciaries conduct an RFP or other competitive bidding process for recordkeeping fees every three to five years.
- 3. Understand a record-keepers total compensation.** Allowing a recordkeeper to cross-sell without obtaining information about cross-selling revenue means Yale was unaware of the recordkeeper's total compensation and whether it was reasonable.

# *Smith v. CommonSpirit Health*

- ***Smith v. CommonSpirit Health.***  
Participants claimed CommonSpirit Health breached its fiduciary duty of prudence to its 401(k) plan participants by selecting a provider's suite of actively managed target date funds when that same provider also had a passively managed version. The participants claimed that the passive funds were less expensive and performed better over certain three-year and five-year periods.

## Key Takeaways:

1. **Active funds are acceptable.** The 6th Circuit Court of Appeals concluded that active funds were a common fixture of plans, and there is nothing wrong with permitting plan participants to choose them in hopes of realizing above-average returns over the course of the long lifespan of a retirement account.
2. **Five-year window insufficient for claiming underperformance of active target date funds.** The Court also rejected the participants' underperforming funds claim. Identifying another investment that has performed better during a five-year snapshot of a fund that is supposed to grow for 50 years does not show imprudence.

# Multiple Lawsuits Alleging Breach of Fiduciary Duty for Offering BlackRock Funds

In 2022, several lawsuits have been filed against plan fiduciaries for using the BlackRock LifePath indexed target date funds claiming the BlackRock funds have had consistently lower returns than other actively managed target date funds. These lawsuits are not expected to be successful because of key distinctions between the BlackRock funds and its comparators:


1. **To-retirement versus through-retirement glidepaths.** Every target-date fund adjusts its asset allocation from more aggressive and growth-oriented early on to more conservative strategies as participants near and enter retirement. Some target-date funds, such as the BlackRock LifePath, offer a to-retirement glidepath. Its comparators offer a through-retirement glidepath.
2. **Passive versus actively managed underlying funds.** The BlackRock LifePath funds are made up of passively managed underlying funds, while most of the higher-returning comparison funds are constructed with actively managed underlying funds. Passively managed funds are designed to yield an average return, while actively managed funds have the goal of outperforming the market. The comparison funds are all funds that have successfully outperformed their benchmark indexes.

# Board Fiduciary Duties in Practice


# How Does the Board Demonstrate it is Properly Exercising its Fiduciary Duties?

Fiduciary Checklist Examples:	Corresponding Board Activities:
Are fiduciaries aware of their duties?	<ul style="list-style-type: none"> <li>• Fiduciary Checklist Review Sept. Board Meeting</li> <li>• New Board Member and Ongoing Fiduciary Training</li> </ul>
Are record keeping fees reasonable?	New contract provides lower administrative fees
Is investment performance reviewed? Are fees being paid for the investment options reasonable?	<ul style="list-style-type: none"> <li>• Quarterly Investment Performance Review</li> <li>• Financial Statement Audit Report June Board Meeting</li> <li>• Fund House Presentations June and Sept. Board Meetings</li> </ul>
Are participant administrative fees reasonable?	Participant Administrative Fee Analysis December Board Meeting
Have participant complaints been documented and resolved?	<ul style="list-style-type: none"> <li>• Board correspondence is passed to the board and response sent as appropriate by WDC Program Director</li> <li>• Formal Administrative Appeals Process</li> </ul>


# Practical Guidance




Follow the Annual Fiduciary Checklist




Review Board Meeting Materials



Ask Questions at Board Meetings



Continue to Hire Experts When Necessary




Review Board Meeting Minutes for Accuracy




Engage in Continued Learning About Fiduciary Topics




Update Plan Documents to Reflect Changes to the Law



Monitor and Evaluate Third-Party Administrator Performance



Monitor and Evaluate Reasonableness of Fees



Monitor and Evaluate Investment Performance

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**Questions?**

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# Thank you

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