Multiemployer Benefit Plans Alert

DUTY OF PRUDENCE FOR PLAN FIDUCIARIES | FEBRUARY 2022

BACKGROUND

On January 24, 2022, the United States Supreme Court published a unanimous opinion in *Hughes v. Northwestern University* that clarifies the duty of prudence owed by plan fiduciaries when offering investment options to plan participants in self-directed accounts. The Court reaffirmed that fiduciaries have a "continuing duty . . . to monitor investments and remove imprudent ones." Below we summarize the case and provide our thoughts on its potential implications for plan fiduciaries.

LOWER COURT RULINGS

In 2016, a group of current and former employees of Northwestern University sued their employer, its Retirement Investment Committee, and the individual administrators of the University's Retirement Plan and Savings Plan. Both of the plans were defined-contribution plans offering participant-directed investment accounts, similar in structure to the annuity plans or supplemental retirement plans offered by many Taft-Hartley employee benefit funds.

The plaintiffs filed suit in federal district court alleging that the fiduciaries of the Northwestern plans had violated their duty of prudence under ERISA in three ways: (1) the plan fiduciaries failed to control and monitor the plan's recordkeeping fees, resulting in unreasonably high costs to plan participants; (2) the plan fiduciaries offered a number of investments that took the form of "retail" share classes with higher fees, rather than "institutional" class shares that were identical except that they carry lower fees; and, (3) the plan fiduciaries offered too many investment options (over 400 total) and that this caused confusion and poor investment decisions by participants.

The District Court granted the defendants' motion to dismiss, finding that the plaintiffs had not stated valid claims under ERISA. The U.S. Seventh Circuit Court of Appeals affirmed the ruling. In its decision the Seventh Circuit focused on the participant-directed nature of the investment accounts, stating that because the plans offered a broad range of choices to participants that included low cost, retail-class investments, there was no viable claim against the plan fiduciaries for breach of their duty of prudence. The Seventh Circuit believed that because the plaintiffs' preferred type of investments were available (i.e., low-cost index funds) they could not complain that other investment options offered under the plan were imprudent. The plaintiffs appealed this ruling to the Supreme Court.

THE SUPREME COURT'S DECISION

The Supreme Court vacated the judgement of the Seventh Circuit in an 8-0 decision. In an opinion authored by Justice Sotomayor, the Court found that the Seventh Circuit had erred in its focus on participant choice, and had failed to apply an earlier Supreme Court precedent regarding fiduciary duties under ERISA from a 2015 case, *Tibble v. Edison International*. In *Tibble*, the Supreme Court determined that plan fiduciaries have an ongoing duty to monitor all plan investments and remove any imprudent ones.

By failing to apply *Tibble* in this case, the Court ruled that the Seventh Circuit erred in finding that participants' "ultimate choice over their investments" excused allegedly imprudent decisions by plan fiduciaries. The Court emphasized that plan fiduciaries have a duty to independently evaluate which investments may be prudently included as options for self-directed investment accounts. The Court stated that fiduciaries must conduct a regular review of their investments, and that if they "fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty." The Court concluded with a reminder to the lower courts that the review of a fiduciary's duty of prudence is a context specific inquiry, and that courts must consider the "range of reasonable judgements" fiduciaries may make given their experience and expertise. Ultimately, the Court remanded the case to the Seventh Circuit.

IMPLICATIONS FOR PLAN FIDUCIARIES AND ADMINISTRATORS

Overall, we feel that this decision reiterates the substance of the duty of prudence owed by Trustees of ERISA-governed benefit plans, especially in the context of participant directed investment accounts. Generally, plan fiduciaries have a duty to continuously monitor the plan's investments, and they must remove investments that are performing poorly within a reasonable amount of time. However, this case does point toward some actions that plan fiduciaries can take to fulfill their duty of prudence:

- Plan fiduciaries should regularly review recordkeeping costs and expense ratios of the investment options offered to participants, to ensure that they meet relevant benchmarks for reasonable costs to participants.
- Plan fiduciaries should review the plan's investment options to determine if they are offering more expensive, "retail" class shares of investments to participants where cheaper, "institutional" class shares are available.
- Plan fiduciaries should examine the investment options offered to participants in self-directed investment programs and modify them as needed to avoid offering investment options that are likely to be confusing or redundant.
- Plan fiduciaries may want to examine the asset allocations of the target-date funds that are often offered as default investments. Target-date funds have recently attracted regulatory scrutiny, and plan fiduciaries may wish to review the allocation of any target-date funds they offer to ensure that they are properly weighted to reduce risk as participants approach their target retirement age.

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