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Fiduciary Update | May 2024

Flow of 401(k) and 403(b) Cases Continues: More Claims Challenge Underperforming Investments

The flow of cases alleging fiduciary breaches through the overpayment of fees in 401(k) and 403(b) plans continues. Claims challenging the improper retention of underperforming investments are increasing. Following are highlights and language from court decisions to remind plan fiduciaries of the standards against which they are judged.

Goldman Sachs was sued for using its own proprietary funds. Plan fiduciaries won in the district court and the appeals court agreed, with the court saying:

- A fiduciary does not breach its duty of loyalty by choosing to retain an investment that, in the fiduciary's reasonable assessment, may perform well in the long term despite short-term underperformance.
- To prevail, a plan participant must introduce evidence that a prudent fiduciary would have acted in a manner that differed from the challenged fiduciaries.
- Although adoption of an investment policy statement (IPS) is a best practice, it is not required that fiduciaries adopt an IPS to be found to have acted prudently. Here, even without an IPS, the committee followed a deliberative and rigorous process when selecting and monitoring investments. *Falberg vs. The Goldman Sachs Group, Inc.* (2nd Cir., 2024).

Fiduciaries of the CMFG Life Insurance Company were sued for imprudently retaining the BlackRock LifePath Index Funds, which had allegedly underperformed. Dismissing the case, the judge noted the following:

- Pointing to another investment that has performed better in a five-year snapshot of the lifespan of a fund that is supposed to grow for 50 years does not suffice to plausibly plead an imprudent decision.

- A prudent fiduciary necessarily must factor long-term outcomes into the investment calculus for retirement funds meant to be managed over decades.
- The duty of prudence requires a fiduciary to make reasonable judgments. It does not require them to pick the best performing fund each year or even each decade. *Abel vs. CMFG Life Insurance Company* (D. Wis., Jan. 2024).

AllianceBernstein fiduciaries were sued for utilizing their own proprietary target-date funds that consistently underperformed. The case was dismissed, with the judge noting the following:

- Virtually any investment vehicle can be said to underperform its benchmark depending on the time frame chosen. ERISA protects participants against imprudence. It does not, however, accord participants an insurance policy against market losses.
- The alleged underperformance occurred over a relatively short period, spanning no more than five years. The greatest magnitude of underperformance vs. the benchmark was 4.57 percent in a single year and does not support a claim for imprudence. *Bloom vs. AllianceBernstein LP* (S.D. N.Y. Mar. 2024).

Recordkeeping and Investment Fees Cases: Process Wins and Attorney's Fees Clipped

Fiduciaries of Hy-Vee's 401(k) plan were sued for overpaying for recordkeeping fees. The plan's fiduciaries followed a diligent process, and the judge found in their favor, noting:

- First and most fundamentally, the committee had an adequate process in place to monitor and evaluate the reasonableness of recordkeeping fees.
- As the plan grew, the committee obtained fee reductions.
- The committee conducted a detailed request for information (RFI) process in 2020 to help determine whether there were better alternatives in the marketplace, ultimately concluding there were not. *Rodriguez vs. Hy-Vee, Inc.* (S.D. Iowa Mar. 2024).

Fiduciaries of the Juniper Networks' 401(k) plan were sued for, among other things, using managed account services that were more expensive and essentially mimicked the available target-date funds.

The suit was settled for $3 million. The plaintiff's counsel initially requested $900,000 in legal fees, which the judge rejected. The request was reduced to $750,000, which was also rejected. Ultimately, fees of $375,000 were awarded—approximately double the amount of fees actually incurred.

Similarly, an initial request was made to pay $5,000 to each named class representative, which was denied. A reduced request for $4,000 was also rejected, and the class representatives were awarded $2,000. *Reichert vs. Juniper Networks* (N.D. Cal. Feb. 2024). Under the settlement, the average participant will receive approximately $370.

Xerox Corporation's plan fiduciaries were sued for utilizing their own firm's recordkeeping services and allegedly overcharging plan participants. The case was settled for $4.1 million. The plaintiff's counsel initially requested $1.37 million in legal fees, 33 percent of the settlement amount. The judge

rejected this amount and instead awarded legal fees of 25 percent of the settlement amount—nearly 4.5 times the amount that class counsel spent on the case. *Carrigan vs. Xerox Corporation* (D. Conn. April 2024). Under the settlement, the average participant will receive approximately $85.

ESG Caution: American Airlines ESG Suit Will Continue

As previously reported, plan participants sued American Airlines for including funds in their 401(k) plan that advance environmental, social, and governance (ESG) causes. The complaint broadly alleged that ESG funds violate ERISA because they support objectives other than plan participants' financial security in retirement. Initially, it appeared that the challenge may have been to the availability of ESG funds in the plan's self-directed brokerage window, but that claim has been dropped from the case.

The plaintiffs are challenging the use of BlackRock funds in the plan. Reportedly, BlackRock has embraced ESG factors in its investment approach, and the plaintiffs allege that it is a breach of ERISA's fiduciary responsibilities to use these investments. Plan fiduciaries filed a motion to dismiss the case, which was denied. So, the case will proceed.

In denying American Airlines' motion to dismiss, the court acknowledged and appeared to accept the general proposition that ESG investments underperform their non-ESG peers. The judge also noted that ESG investments are not exclusively focused on financial gain to plan participants. Finally, the judge observed that American Airlines' corporate commitment to ESG initiatives supports the argument that ERISA's duty of loyalty was breached by the plan fiduciaries. *Spence vs. American Airlines, Inc.* (N.D. Tex. Feb. 2023).

New DOL Guidance: Expanded Fiduciary Definition and Automatic Portability

Expanded Fiduciary Definition: Undeterred by previous regulations being struck down by the courts, the Department of Labor (DOL) has issued another rule attempting to expand the range of providers who are required to act in their client's best interests.

It is well settled that ERISA fiduciaries are required to act in plan participants' best interests. However, ERISA applies only to plan assets. Once assets leave a plan, participants are no longer protected. Therefore, without additional regulation, individuals like stockbrokers and insurance agents can act in their own or their company's best interests rather than in their clients' interests.

The DOL's new fiduciary rule is intended to protect retirement savers as and after assets leave retirement plans. It applies to those who provide investment advice for a fee as a regular part of their business in circumstances where the client believes the advice is tailored to their situation and is in their best interests. Alternatively, providers can also acknowledge that they are acting as a fiduciary under ERISA. The new rule is scheduled to take effect on September 23, 2024. However, litigation is expected.

Automatic Portability: The SECURE 2.0 Act enabled automatic portability services that cause a

terminating plan participant's account to follow the participant to a new employer's plan. This can be used for small account balances of $7,000 or less. Both the terminating employer and the new employer must be enrolled in the portability service. Transfer between plans is a three-step process.

1. The distributing plan initiates a mandatory rollover distribution into an individual retirement account (IRA) for the participant.
2. The default IRA holds the rolled-over assets, pending direction by the portability provider to move the assets to the new employer's plan. The portability provider tracks default IRA accounts and the accounts in potential receiving plans for matches.
3. The receiving plan receives the assets from the default IRA when the owner is matched by the portability provider with an account at a participating plan.

For plans that participate in an automatic portability program, there are some responsibilities:

- Plan fiduciaries are responsible for selecting a portability provider.
- Plan fiduciaries are responsible for ongoing monitoring of the portability provider.
- Plan sponsors are required to ensure that fees charged by portability providers are reasonable.
- Plan sponsors have a duty to monitor automatic portability transfers to assure that assets received by their retirement plan are properly invested according to the participant's allocation or to the qualified default investment alternative (QDIA).
- Plan communications must include a description of the service, which will frequently be handled by the plan's recordkeeper.
- Plan sponsors should also likely assess whether the portability provider's cybersecurity program meets the DOL's best practice guidelines.

Divorced Couple's Notarized Agreement Ignored: Plan Documents Prevail

Diann and Boyd Badali were divorced. Their divorce documents did not address Boyd's employer-provided life insurance. Boyd remarried, then died 15 months after his remarriage. Following his death, both Diann and Renata Badali, Boyd's wife at the time of his death, claimed his life insurance proceeds.

Before Boyd remarried, he and Diann had entered into a signed and notarized agreement to "update and clarify their divorce decree." The agreement provided that Boyd would "keep Diann as beneficiary on the employer-provided life insurance policy."

The plan document provided that, if there were no beneficiary designation, the death benefit would go to the surviving spouse. No beneficiary designation could be located, so Renata Badali, Boyd's wife at the time of his death, was awarded the death benefits.

The court noted that equitable considerations like Boyd's intent, as included in the notarized agreement, cannot come into play in an ERISA-covered plan when the plan language is clear, as it was in this situation. *Metropolitan Life Insurance Company vs. Badali* (D. Utah Feb 2024).