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Indexed Target Date Funds Challenged in 401(k) Litigation for Too Low Returns

In an interesting twist, the focus of attacks on 401(k) plan fiduciaries has expanded to include challenges to the use of low-cost indexed target date funds. Approximately 10 lawsuits have been filed against plan fiduciaries for using the BlackRock LifePath indexed target date funds. The challenge claims the BlackRock funds have had consistently lower returns than the most-used and best-performing, (mostly) actively managed target date funds. The T. Rowe Price Retirement Funds and Fidelity Freedom Funds were cited as examples, among others.

Different from the all-too-familiar claims in nearly 200 recent lawsuits that challenged 401(k) plan fees, expenses, and sometimes investment performance, these lawsuits challenge only investment performance.

They allege that investment returns were sacrificed in favor of low costs. However, there are two critical differences in the BlackRock funds versus the funds they are being compared with that are likely major contributors to performance differences.

- **To-retirement versus through-retirement.** A key element of target date fund design and construction is whether the gradual shift along the glidepath from more equities and fewer bonds to fewer equities and more bonds stops at a target retirement age (65, for example) or continues past it. Target date funds that stop the glidepath shift upon reaching the target retirement age are referred to as *to-retirement* strategies, while those that continue to grow more conservative after a target retirement age is reached are called *through-retirement* strategies. It can be expected that to-retirement strategies will generally have lower equity

exposure than their through-retirement counterparts. This can lead to higher long-term returns for through-retirement funds than for to-retirement funds in certain market cycles. The BlackRock LifePath funds are to-retirement strategies, but they are being compared to through-retirement strategies.

- **Active versus passive.** 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 investments are designed to match their target indexes, while actively managed funds are designed to outperform their benchmark indexes. The comparison funds are all funds that have successfully outperformed their benchmark indexes.

There are legitimate and prudent reasons for plan fiduciaries to select target date funds with either a to-retirement or a through-retirement strategy, and with either actively managed or passively managed underlying fund components. It's also paramount that plan fiduciaries understand they have no responsibility, per ERISA, to select the best-performing investment options or the cheapest. However, in a familiar refrain from prior Fiduciary Updates, it is essential that those choices be made through a thoughtful evaluation and selection process. It is equally important that those decisions be well documented.

UnitedHealth Group CFO Added as an Individual Defendant in Lawsuit Challenging the Retention of Underperforming Target Date Funds

UnitedHealth Group (UnitedHealth) is the subject of another lawsuit challenging fiduciaries' use of target date funds. The complaint, filed in 2021, alleges that the company's retirement plan continued to offer Wells Fargo target date funds from 2015 to 2021, even though they consistently and significantly underperformed. *Snyder v. UnitedHealth Group* (D. Minn. 2021).

Through the litigation discovery process, the plaintiffs claim to have found evidence that although the UnitedHealth fiduciary committee had determined to remove the Wells Fargo funds, the CFO interceded to keep those funds in place. An amended complaint was filed in August 2022, adding the CFO as an individually named defendant. The amended complaint alleges that the CFO directed a comparison of UnitedHealth's business relationships with Wells Fargo and the firms whose funds were candidates to replace Wells Fargo. Upon determining that Wells Fargo was a significant business partner, the decision was made to retain the Wells Fargo funds. Soon after, the plan's fiduciary committee was restructured to include the CFO, who had not previously been a member. The complaint contends that UnitedHealth's business success took precedence over the interests of plan participants, thereby violating ERISA's exclusive benefit rule and causing losses for plan participants.

So far, only the plaintiff's allegations are known. Counsel for the defendants issued a statement noting that lawyers may choose to pursue baseless claims and stating that allegations against the CFO are completely without merit.

This case and the multiple lawsuits challenging the BlackRock LifePath funds (reviewed earlier in this Fiduciary Update) underscore the importance of carefully selecting and monitoring target date funds—along with a plan's other investments.

Recent Decision in *CommonSpirit* Supports Fee Case Dismissals by Two Other Circuit Courts of Appeal

Last quarter, we reported on a decision from the Sixth Circuit Court of Appeals affirming the dismissal of a 401(k) plan fees case in *CommonSpirit.* Relying on the reasoning in that case, dismissals have also been upheld in the Seventh and Eighth Circuits. These cases and other recent dismissals at the district court level are a departure from a recent trend of allowing these cases to proceed. This may indicate that courts are developing a more complete understanding of this area.

In *Albert v. Oshkosh Corp.* (7th Cir. 2022), now-familiar claims were filed, alleging too-high fees among other complaints. Affirming dismissal, the court said the following:

- Regarding an allegation that recordkeeping fees were too high: "We previously rejected the notion that a failure to regularly solicit quotes or competitive bids from services providers breaches the duty of prudence."

CAPTRUST comment: Even though this statement provides some breathing room for fiduciaries, it is a fiduciary duty to pay only reasonable fees for plan services. We believe it is a best practice to periodically benchmark fees against similar plans and services.

- Regarding the use of the least expensive share classes—that is, net of revenue sharing that is allocated back to participants' accounts that use the revenue-share-producing investments—the court rejected this argument, saying, "This is a novel theory."

CAPTRUST comment: While this particular court may view this as a novel approach, a significant number of plans utilize it, and one recently filed fees case directly alleges a fiduciary breach in not using it. There is no one right way to pay for plan fees, but a full understanding of all plan fees is required.

- Regarding mutual fund investment expenses, "The fact that actively managed funds charged higher fees than passively managed (index) funds is ordinarily not enough to state a claim."

In *Matousek v. MidAmerica Energy Company* (8th Cir. 2022), again, familiar claims were made. Affirming dismissal, the court said the following:

- Regarding an allegation that recordkeeping fees were too high: “After all, we have been clear that the key to stating a plausible excessive-fee claim is to make a like-for-like comparison.”The court rejected the use of general industry benchmarks that did not demonstrate an apples-to-apples comparison.

CAPTRUST comment: Periodic like-to-like benchmarking is a best practice.

- Regarding a claim that underperforming funds were retained, the court determined that the complaint was not sufficient because it did not include a meaningful comparison to demonstrate that the currently used funds actually underperformed. However, “in one earlier case a combination of a market index and other shares of the same fund did the trick, but there is no one-size-fits-all approach.”

CAPTRUST comment: It is a best practice to periodically review and evaluate plan investments relative to appropriate benchmark and peer group data—and document those reviews.

Two District Courts Conclude Plan-Related Data is Not a Plan Asset

A wide-ranging lawsuit was brought against Automatic Data Processing, Inc, making the usual allegations of overpaying fees and retaining underperforming investments. This suit also included the claim that plan data is a plan asset and that plan fiduciaries breached their responsibility by allowing the plan recordkeeper, Voya, to use participant data to solicit plan rollovers and sell other products. The court decided that plan data is not a plan asset and dismissed that claim. The court did note that it is possible that plan fiduciaries should have limited Voya’s use of plan data, but nothing in the complaint supported a finding that failure to do so caused losses or harm. *Berkelhammer v. Automatic Data Processing Inc.* (D. N.J. 2022).

In the second case, TIAA-CREF was challenged for using plan data to encourage plan rollovers and sell other services. The judge stated in his opinion that due to TIAA’s lagging market share in the retirement plan space it took action to support its business and implemented a multi-step approach. This strategy included offering free financial planning services to plan participants so the company could decide whom to target for other services. The company also implemented processes to encourage internal advisors to sell other services. The court concluded that plan data was not a plan asset that could give rise to TIAA being a fiduciary or committing a fiduciary breach for the data’s misuse. *Carfora v. Teachers Insurance Annuity Association of America* (S.D. N.Y. 2022).

Although these cases do not find a fiduciary responsibility for the use of plan assets, plan fiduciaries will likely want to be aware of any cross-selling and ancillary services provided to their employee/participants by plan recordkeepers. Also, this is a developing area and not all courts will necessarily reach a similar conclusion, depending on the facts and circumstances.

Independent Fiduciary Provides Shield to Plan Fiduciaries in Employer Stock Case

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Boeing’s 401(k) plan permits plan participants to invest in Boeing stock. For more than 15 years, the Boeing Investment Committee has retained an independent fiduciary who has both independent and exclusive responsibility for monitoring Boeing stock as a plan investment. After two fatal crashes of Boeing’s 737 MAX aircraft, the company’s stock lost considerable value. In the wake of the second crash, plan participants sued Boeing and its fiduciary committees, alleging that—after the first crash and the subsequent recovery of the flight data recorder—Boeing knew and concealed the risks of the 737 MAX aircraft. They argued that Boeing stock should have been eliminated from the plan. A lawsuit was not brought against the independent fiduciary.

The court evaluated the respective roles of Boeing, its fiduciary committees, and the independent fiduciary. It concluded that with the appointment and delegation of exclusive responsibility for the Boeing stock to the independent fiduciary, neither Boeing nor its committees had a fiduciary role or responsibility with respect to the Boeing stock. As a result, the case was dismissed. Dismissal was appealed to the Seventh Circuit, which affirmed dismissal. *Burke v. Boeing Co.* (7th Cir. 2022).

This case illustrates a potential benefit of retaining an independent fiduciary in employer stock situations that may warrant it.