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Supreme Court reaffirms duty to continuously monitor plan investments and service provider fees

In *Hughes v. Northwestern University*, the U.S. Supreme Court unanimously reversed the Seventh Circuit Court of Appeals and ruled that a claim for fiduciary breach cannot be dismissed solely because a plan offered a wide variety of investment options from which participants can choose, some of which were prudent.

Background

ERISA requires fiduciaries to administer plans prudently according to their terms and for the exclusive benefit of participants and beneficiaries. The fiduciary's duty of prudence includes, among other things, the duty to diversify investments (unless it is clearly prudent not to do so), prudently select and monitor the plan's investments, and ensure that expenses charged to the trust are limited to reasonable expenses of administering the plan.

In 2015, the Supreme Court ruled on a similar case involving a claim of breach of fiduciary duty (see *Tibble v. Edison*). The *Tibble* decision relied heavily on the trust-law principle that a fiduciary must "conduct a regular review of its investment with the nature and timing of the review contingent on the circumstances." Under trust law, which courts frequently look to in analyzing ERISA's fiduciary duties, a trustee has a continuing duty to monitor investments and remove imprudent ones.

In *Hughes v. Northwestern University*, plan participants alleged that the fiduciaries of two defined contribution plans' (both of which were IRC section 403(b) plans) violated ERISA by:

- Failing to monitor and control recordkeeping fees by permitting investment in funds with high expense ratios, and employing multiple recordkeepers, resulting in higher than necessary indirect costs to the participants;

- Offering several retail-class mutual fund shares in the plan's investment menu that carried higher fees than similar "institutional" share investments; and
- Offering too many investment options (242 in one plan, and 187 in another), which caused confusion and led to poor investment decisions by participants.

The plaintiffs also claimed that the fiduciaries engaged in prohibited transactions by allowing imprudent funds to be offered, and not negotiating lower "per-capita" based fees on the plan's behalf.

Upholding a district court decision, the U.S. Court of Appeals for the Seventh Circuit affirmed its dismissal of the entire case because the low-cost index investments the petitioners preferred were also available under the plans, which eliminated any concerns that other plan options might be imprudent. Also, the Seventh Circuit reasoned that since the plan's recordkeeping expenses were paid indirectly through the plans' investments, participants (who directed their own investments) could have directed their investments into lower expense funds. The Seventh Circuit stated that there is no requirement under ERISA to have fees determined on a per-capita basis. The prohibited transaction claims were also dismissed for the same reasons.

Lower court erred in relying on participant choice to dismiss claims of excessive cost and potentially imprudent investment options

A unanimous Supreme Court held that the Seventh Circuit erred in relying on participants' investment choice to excuse potentially allowing imprudent investment options to remain in the plan. In doing so, the Seventh Circuit failed to apply the *Tibble* guidance regarding the continuing duty to monitor investments — a well-worn principle of trust law. In *Tibble*, the Supreme Court stated that "plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plans menu of options." As in *Tibble*, the Supreme Court did not define the scope of the duty to review existing plan investments but sent the case back to the Seventh Circuit to determine what that duty requires and whether the fiduciaries fulfilled such requirements.

The Supreme Court stated that the duty of prudence is context-specific, based on the circumstances then prevailing, acknowledging that "at times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make…".

Scope of monitoring still unclear

While holding that the Seventh Circuit erred by failing to consider the continuous duty to monitor all investment options, the Supreme Court did not determine the scope of the fiduciaries' monitoring responsibilities. It also did not address the issue of whether the plan's use of multiple recordkeepers (as is not unusual for 403(b) plans) caused the plan to overpay for administrative services. Thus, it remains unclear whether the fiduciaries' review of the funds in question was sufficient. Indeed, the

Supreme Court carefully avoided expressing any view on the merits of the participants' claims, so it is possible that after the Seventh Circuit considers trust-law principles, it could conclude that the fiduciaries acted prudently.

In closing

It is now up to the Seventh Circuit to decide when and whether the funds in question should have been examined and removed from the plan's investment line-up. Fiduciaries aiming to avert challenges to their own decisions should ensure processes for periodically reviewing the continued appropriateness of each ongoing plan investment are in place, duly documented, and rigorously applied.