EMPLOYEE BENEFITS LAW
INFORMATION MEMO
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Supreme Court Considers Breach by Plan Fiduciaries in Hughes v. Northwestern University

On Jan. 24, 2022, the U.S. Supreme Court reached a unanimous decision, overturning the Seventh Circuit's dismissal of participants' claims that fiduciaries breached their duty of prudence – sending the case back to the Seventh Circuit for reconsideration. This case involved a challenge of the actions taken by fiduciaries concerning management of their defined contribution plans – alleging that fiduciaries failed to monitor plan investments and recordkeeper fees, triggering a breach of their fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended (ERISA).

In its holding, the Court found that fiduciaries failed to satisfy their fiduciary obligations by offering "retail" class investments (with higher fees) over essentially indistinguishable "institutional" class investments (with lower fees), using recordkeepers that charged excessive fees, and maintaining a substantially large menu of investment options that could confuse participants and contribute towards poor investment elections. The decision shows that plan fiduciaries' obligations to monitor investments and control fees are not extinguished by offering a diverse menu of funds (including some prudent funds) and relying on the participants' ability to choose, but rather must be applied on a fund-by-fund basis. As a result of this decision, plan fiduciaries should review their own internal policies and procedures addressing the monitoring of plan investments and recordkeepers (as well as their own current investment lineup) to ensure they correspond with the Court's ruling.

The case at hand involved participants in two (2) Northwestern University retirement plans (the Plans) – defined contribution retirement plans, permitting participants to defer compensation into individual investment accounts and invest those contributions into an array of specific investment options. The investment return, or loss, on these investment options, as well as the fees charged, dictate the amount of funds available at retirement. Fees charged primarily fall into two categories: those for investment services (i.e., fees that compensate funds for designing and maintaining the investment); and those for recordkeeping (i.e., fees for tracking account balances, providing account statements, and offering informational and accessibility services to participants).

The petitioners brought suit against Northwestern University, its retirement investment committee and those individuals who administer the Plans, arguing that they, as fiduciaries, breached their fiduciary duty of prudence under ERISA by: (i) failing to monitor and control recordkeeping fees, as compared to peer universities with similarly sized plans; (ii) offering retail share class investment funds, with higher fees, rather than institutional share classes of the same funds, with lower fees; and (iii) offering an excessive number of investment options (over 400 in total), causing confusion and contributing to poor investment decisions.

The Seventh Circuit initially affirmed the dismissal of the case by the District Court, reasoning that the fiduciaries of the Plans did, in fact, offer the preferred low-cost investment options desired by the participants, amongst other funds available for investment (including those with higher fees). The court

reasoned that, since participants were free to invest in their preferred lower cost investment funds, the Plans' fiduciaries met their fiduciary burdens under ERISA, despite also including other similar higher costs options.

The Supreme Court rejected these findings, concluding that ERISA imposes a fiduciary duty to regularly monitor and review all plan investments and recordkeeping expenses and to remove those imprudent investments or recordkeepers within a reasonable amount of time. The Court noted that the Seventh Circuit incorrectly focused on the fiduciary duty to offer a diverse menu of investment options – reasoning that fiduciaries must independently evaluate each investment option offered under the Plans and cannot sidestep this obligation by offering a broad range of investments, allowing participants to avoid those investments that did not appeal to them. Plan fiduciaries have a continuing obligation to monitor all investments and timely remove imprudent ones from the plan's investment lineup.

The key takeaway from this decision is that defined contribution plan fiduciaries will not be able to avoid liability from offering imprudent investments solely because they provide a variety of investment options. Plan fiduciaries have an ongoing duty to maintain a prudent investment lineup and protect their participants from bad investment decisions by monitoring their lineup and removing imprudent options from their fund menu. To this end, plan fiduciaries should take this opportunity to review their fund lineup to determine if action is necessary to remove imprudent investment options. On a macro level, plan sponsors should review their internal monitoring and decision making processes and procedures – especially when it comes to evaluating plan fees, investments, and service providers (including recordkeepers) – to ensure they are satisfying their fiduciary obligations.

If you have any questions, please contact Lawrence J. Finnell, any attorney in our Employee Benefits and Executive Compensation practice or the attorney at the firm with whom you are regularly in contact.

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