Supreme Court Holds That Reasonably Prudent ERISA Fiduciaries Must Monitor Recordkeeping and Investment Manager Fees for All Investments

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Key Points

- 401(k) plan fiduciaries have the duty to monitor reasonableness of fees for all investment options available to participants under a 401(k) plan.
- Offering low-fee investment options does not alleviate the 401(k)'s fiduciaries from the duty to monitor the reasonableness of the fees under all of the plan's investment options.
- Offering too many investment options in a 401(k) plan, in some circumstances, may constitute a breach of a plan fiduciary's duty to monitor investments.

In a decision likely to have a broad impact on Employee Retirement Income Security Act (ERISA) plan fiduciaries, the Supreme Court reversed a lower court and held that a breach of fiduciary duty claim which alleged that the fiduciaries of two defined contribution plans sponsored by Northwestern University failed to properly monitor their offered investments could proceed to discovery.

In *Hughes v. Northwestern University*, three plaintiffs sued Northwestern University, the Committee that administered Northwestern's two defined-contribution plans and the individual members of the Committee. The Committee (as the named fiduciary under the plans) and the individual members were alleged to be the parties responsible for selecting and monitoring the plans' investment options. The plaintiffs alleged that Northwestern University, as the sponsor of the plan, breached its fiduciary duty to monitor the Committee and its members in carrying out their duties as plan fiduciaries. The plaintiffs further asserted that the plans' fiduciaries failed to act in a reasonably prudent manner by (1) paying unreasonably high recordkeeping fees, (2) offering investment options with unreasonably high management fees and (3) offering far too many (over 400) investment options resulting in confusion to the plan participants. One example of the defendants' fiduciary breach was the inclusion of an investment option that provided for "retail" classes of shares having higher fees when identical, lower cost, classes of shares were also available.

After the district court dismissed the complaint, the 7th Circuit affirmed on the ground that the two plans offered low-fees investment options, including low-cost index funds, that participants could have selected. The lower courts found that offering investment options with low fees created a safe harbor from fiduciary breach claims and that it was not necessary for the fiduciaries to determine if all investment options were offered at reasonably prudent fees.

In reversing the 7th Circuit's judgment, the Supreme Court held that, under the analysis from its earlier decision in *Tibble v. Edison Int'l*, a defined contribution plan's offering of low-fee investment options was not determinative on the question of whether the plans fiduciaries acted as reasonably prudent fiduciaries in selecting and monitoring the plans' investment options. Rather, *Tibble* requires that a plan's fiduciaries must monitor every investment option available in a defined contribution plan and must eliminate any such option that is not prudent. The Court thus remanded this case so that the lower courts could make a determination as to whether each of the investment options available under the Northwestern defined-contribution plans was a prudent investment option and, if not, whether the fiduciaries could stand trial for breach of their fiduciary duties and face liability to restore any losses to the plans as a result of these breaches (e.g., refund of excessive fees or even lost income on those fees).

This decision will likely have a broad impact on many plan fiduciaries. After *Tibble*, most defined contribution plans were careful to assure that low-fee investment options were available to their participants, but many still offered other investment options that could be subject to similar claims by plan participants. Now, after *Hughes*, offering too many investment options could lead to similar fiduciary concerns as offering too few. And the more options offered, the more burden placed on the plan fiduciaries to monitor those options.

In light of this decision, sponsors and fiduciaries should evaluate the investment line-ups offered in their defined-contribution plans to assure that:

- Investment options are diversified, but are not overly cumbersome or confusing, to allow for regular monitoring by the fiduciaries.
- Investments offered under each investment option are held at the lowest fee class available and that the fees are comparable to fees charged by similar investments.
- Record-keeping fees are comparable to the per-participant fee charged other defined contribution plans of similar size.

To avoid similar breach of fiduciary claims based on a failure to act as reasonably prudent fiduciaries, plan fiduciaries and sponsors are on notice that they must consult with their plan professionals and regularly review all investment options offered under their plans to assure that their investment options performance and fee structures are reasonable and prudent.

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