Challenges Facing Defined Contribution Plans

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International Foundation OF EMPLOYEE BENEFIT PLANS

Agenda

- Participants' engagement with investments
  - Participant directed
  - Trustee directed
- 401(k) vs. other plan types for the multiemployer world
- Secure 2.0 implications
  - A look at some key provisions
- How to complement your Defined Benefit (DB) plan (if you have one)
  - Plan provisions and investment considerations
- Lessons learned from Defined Contribution Litigation

Participant Directed Investment Challenges

- Investment offering options
  - Core menu construction
  - Target date and/or target risk
  - Managed accounts and personalization
    - How many choices, paralysis from analysis
    - ERISA 404(c) protection

Trustee-Directed Investment Challenges

- Fiduciary risk
  - Member demographic considerations
    - Various time horizons
    - Various risk tolerances
- In house asset management vs. outsourcing
- Reporting and administration factors

401(k) vs. Other Plan Types for the Multiple Employer World

- Benefits of the 401(k)
- Other plan type considerations
  - Loan feature considerations

Secure 2.0

- Over 90 provisions in Secure 2.0
  - Thankfully, the majority are voluntary)
- Emergency savings accounts
- Rothification of catch-up contributions
- Matching contributions on student loan debt payments
- Long-term part-time definition and implications

How to Complement Your Defined Benefit (DB) Plan (If You Have One)

- Offering a DB and DC Plan, some considerations
- Plan design considerations
- Investment considerations
  - Risk-based instead of target date
  - If target date, a more aggressive glide path?

Litigation Trends in the DC Space

- Current trends
  - Investment fees, share classes, recordkeeping fees
- Developing trends
  - Forfeiture usage
- Future issues
  - Brokerage window, auto-IRA, managed accounts

ERISA 104(b)(4) Request for Documents

- ERISA Section 104(b)(4), plan administrators must, "upon written request of any participant or beneficiary, furnish a copy of the latest updated summary[] plan description, and the latest annual report, any terminal report, the bargaining agreement, trust agreement, contract, or other instruments under which the plan is established or operated.“
- Adv. Op. 97-11 (Although section 104(b)(4) includes the term "contract" in its specific delineation of documents required to be furnished, it is the Department of Labor's view that this term does not necessarily encompass all contracts between a plan and third parties who render services to the plan).
- *Murphy v. Verizon Commc'ns, Inc*., No. 13-11117, at *7-8 (5th Cir. Oct. 15, 2014)(“We agree with the majority of the circuits which have construed Section 104(b)(4)'s catch-all provision narrowly so as to apply only to formal legal documents that govern a plan.”)

Excessive Fee Allegations

- Investments
  - Fees are too high compared to the fees of comparable funds. See e.g., *Divane v. Nw. Univ, 953 F.3d 980, 990 (7th Cir. 2020)*
  - Failure to take into account revenue-sharing fees paid to record keepers and other third parties by mutual fund managers. See e.g., *Vellali v. Yale Univ., 308 F. Supp. 3d 673, 685 (D. Conn. 2018)*
  - Offering more actively managed funds instead of index funds. See e.g., *Garthwait v. Eversource Energy Co., No. 3:20-CV-00902 (JCH), at *4 (D. Conn. Sep. 27, 2021)*
  - Offering retail class mutual funds instead of institutional class funds. See e.g., *In re: M T Bank Corp. ERISA Litig., No. 16-CV-375 FPG (W.D.N.Y. Sep. 11, 2018)*
- Recordkeeping fees too high

Hughes v. Northwestern U., 42 S. Ct. 737 (2022)

- Fiduciaries are required to independently monitor all of the plan's investment options and remove imprudent ones.
- This would require fiduciaries to periodically conduct a "context-specific inquiry" to monitor each investment option for prudence.
- "At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs ...."
- "[C]ourts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."

Hughes II (7th Cir. March 23, 2023)

- 7th Circuit—Granted in part and denied in part defendants MTD
- To state a plausible claim, a plaintiff must allege facts sufficient to eliminate "obvious alternative explanations"
- Recordkeeping Claim—It was sufficient for plaintiffs to allege NW could have reduced the plans" recordkeeping fees by 80% by switching to a flat fee
- Share Class Claim—Failure to swap out retail for institutional shares was outside the range of reasonable decisions a fiduciary could take
- Duplicative Funds Claim—To the extent investor confusion is the injury pleaded, the complaint does not identify how plaintiffs were confused and personally injured

Smith v. CommonSpirit Health (6th Cir. 2022)

- Affirmed dismissal of Plaintiffs' fiduciary breach claims based on 401(k) plan offering higher-cost, actively managed investment options when lower-cost index funds with better returns were available.
- Held that pointing to an investment that performed better in a five-year period for a fund that is supposed to grow for fifty years does not plausibly plead an imprudent decision.
- Comparing actively and passively managed funds, without consideration for each fund's discrete objectives, "will not tell a fiduciary which is the more prudent long-term investment option."
- Found that plaintiffs failed to plead that recordkeeping and management fees were excessive relative to the services rendered.

Albert v. Oshkosh (7th Cir. 2022)

- Allegations
  - Paying high fees to its record keeper as compared to other plans
  - Selecting and failing to remove investments that charged excessive investment fees
  - Offering too many actively managed funds with higher investment fees
  - Authorizing the plan to pay excessive investment advisory fees to its advisor, when the plan could have hired similar advisors with lower costs and better performance records
- Fees are not to be considered in a vacuum but in comparison to the quality of the services being provided; No need to "scour the market"

Albert v. Oshkosh (7th Cir. 2022)

- Allegations of excessive recordkeeping fees based on the fees paid by similarly sized plans are without merit since the comparison does not consider the quality or type of services provided by its current service provider
- The fact that the actively managed funds charge higher fees than index funds is not enough to state a claim since the actively managed funds may produce higher returns
- Allegations were "paper thin"—Plaintiff did not explain why its advisor's fees were excessive and unreasonable as compared to other service providers

Matousek v. MidAmerican Energy Co. (8th Cir. 2022)

- "[W]e have been clear that the key to stating a plausible excessive-fees claim is to make a like-for-like comparison," which requires sound and meaningful benchmarking
- Recordkeeping claims: The court echoed the other Circuits and could not infer imprudence unless similarly sized plans spend less on the same services
- Investment claims: No sound comparisons
  - Missed "details [as to] whether they hold similar securities, have similar investment strategies, and reflect a similar risk profile"
  - Provided aggregate data that fails "to connect the dots in a way that creates an inference of imprudence"
  - Comparators were "just different"

Manney v. Barrick Gold of N. Am., 80 F.4th 1136 (10th Cir. 2023)

- Affirms motion to dismiss.
- To raise an inference of imprudence through price disparity, a plaintiff has the burden to allege a context-specific meaningful benchmark.
- To compare investment management fees, a meaningful comparison will be supported by facts alleging alternative investment options with similar investment strategies, objectives, or risk profiles to the plan's funds.
- With recordkeeping fees, a comparison will be meaningful if the complaint alleges that the recordkeeping services rendered by the chosen comparators are similar to the services offered by the plaintiff's plan.
- Here the complaint failed to meet these standards.

Forfeiture Claims Add On

- Forfeitures—IRS long-standing guidance provides that these funds can be used to pay for administrative expenses, reduce employer contributions, or add an additional benefit.
- The plan documents provide that "the company shall allocate and use all or a portion of the amount of a Participant's benefit forfeited under the Plan either to pay reasonable expenses of the plan (to the extent not paid by the employer) or to reduce employer contributions
- Breach of fiduciary duty of loyalty and prudence
- Prohibited transaction

Falberg v. Goldman Sachs Grp., Inc., No. 22-2689-CV, 2024 WL 619297 (2d Cir. Feb. 14, 2024)

- The Second Circuit affirmed the lower court's grant of summary judgment in favor of Goldman Sachs.
- Breach of Fiduciary Duty Claim—Duty of Loyalty
  - Goldman employed a robust process to manage potential conflicts of interest.
  - The Committee participated in fiduciary training sessions.
  - The Committee retained an investment consultant to act as an independent advisor and provide unbiased advice.
  - "[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."

Falberg v. Goldman Sachs Grp., Inc., No. 22-2689-CV, 2024 WL 619297 (2d Cir. Feb. 14, 2024)

- Breach of Fiduciary Duty Claim—Duty of Prudence
  - "The duty of prudence 'focuses on a fiduciary's conduct in arriving at an investment decision, not on its results, and asks whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment.'"
  - Having an Investment Policy Statement is useful, but not required.
  - "[E]ven without an IPS, the Committee followed a deliberative and rigorous process when selecting and monitoring investments. The Committee's independent advisor continually monitored and evaluated the Plan's investment options, and provided the Committee members with detailed information, 'including monthly and quarterly performance reports, written reports summarizing meetings with investment managers, . . . commentary and other information requested by the Committee on a periodic basis.' Committee members reviewed those reports prior to attending Committee meetings."

Spence v. Am. Airlines, Inc., No. 4:23-CV-00552-O, 2024 WL 733640, (N.D. Tex. Feb. 21, 2024)

- Plaintiff advanced two theories of liability
  - Challenged Fund theory: AA used the plan to invest in ESG funds and the ESG funds underperformed compared to similar funds. AA should have removed the ESG funds from the plan.
  - Challenged Manager theory: AA knowingly included funds that are managed by investment managers that pursue ESG policy goals through proxy voting and shareholder activism
- "... the Court determines that requiring a benchmark for measuring performance is not required at this stage given the inherent fact questions such a comparison involves. And, importantly, the Fifth Circuit has not imposed a performance-benchmark requirement."

Imprudent Investment Cases Related to BlackRock Target Date Funds Dismissed

- Lawsuits filed challenging the use of BlackRock's passively managed TDF CITs.
  - Critical of passive management
  - Critical of the use of manager's custom benchmark
  - Compare performance to the top 6 largest TDF suites (including active)
  - Allege fiduciaries were chasing low fees
  - Critical of "to retirement" glide paths vs. "through retirement"
- Motions to dismiss granted in 6 cases.
  - Mere allegations of underperformance do not state a claim.
- Motions pending in remaining cases.

Imprudent Investment Cases Related to BlackRock Target Date Funds Dismissed

- MTD granted
  - *Bracalente v. Cisco Sys., Inc.*, No. 5:22-CV-04417-EJD, 2023 WL 5184138, at *1 (N.D. Cal. Aug. 11, 2023)
  - *Anderson v. Advance Publications, Inc.*, No. 22 CIV. 6826 (AT), 2023 WL 3976411 (S.D.N.Y. June 13, 2023)
  - *Tullgren v. Hamilton*, No. 122CV00856MSNIDD, 2023 WL 2307615 (E.D. Va. Mar. 1, 2023)
  - *Hall v. Cap. One Fin. Corp.*, No. 122CV00857MSNJFA, 2023 WL 2333304 (E.D. Va. Mar. 1, 2023)
  - *Beldock v. Microsoft Corp.*, No. C22-1082JLR, 2023 WL 1798171 (W.D. Wash. Feb. 7, 2023)
  - *Beldock v. Microsoft Corp.*, No. 22 Civ. 1082, 2023 WL 3058016, at *3 (W.D. Wash. Apr. 24, 2023)

Trauernicht v. Genworth Fin. Inc., No. 3:22CV532, 2023 WL 5961651, at *13 (E.D. Va. Sept. 13, 2023)

- Defendant's Motion to Dismiss under Rule 12(b)(6)—Denied
  - "Because the SAC alleges facts that show that the breach caused the loss because a prudent fiduciary properly monitoring the performance of the BlackRock TDFs would have replaced the funds, this ground for dismissing COUNT ONE is rejected."
  - SAC "provides ample detail on the underperformance of the BlackRock TDFs and how the underperformance would have signaled the need for a change to a prudent fiduciary"
  - the SAC's allegations respecting the Sharpe ratios are to be taken as true, and they are plausible."

Request for Proposal

- RFPs may help demonstrate reasonability.
  - *White v. Chevron* (N.D. Cal. 2016)
    - Finding "no legal foundation" for allegations that plan fiduciaries were "required to solicit competitive bids on a regular basis."
  - *George v. Kraft Foods* (7th Cir. 2011)
    - An independent opinion is not a magic wand that a fiduciary may simply waive over a transaction to ensure their responsibilities are fulfilled (citing to *Donovan v. Cunningham*, 5th Cir. 1983).
    - Holding that a "trier of fact could reasonably conclude that defendants did not satisfy their duty to ensure [recordkeeper's] fees were reasonable" where the plan fiduciaries failed to solicit competitive bidding for more than 15 years.

Request for Proposal

- *Brown v. The Mitre Corp.* (D. Mass. 2023)
  - Plaintiffs' allegations that the Fiduciary Committee failed to conduct an RFP at reasonable intervals are sufficient to infer imprudence.
- Objectively illicit information about the quality of services vs. fees charged (DOL A.O. 2002-08A (August 20, 2002)
- The demographics and unique characteristics of the participants and beneficiaries may also be relevant.

Request for Proposal

- Lowest bidder is not the standard
  - Caveat Emptor
  - Not required to "scour the market" *Hecker v. Deere Co.* (7th Cir. 2009)
  - DOL "A Look at 401(k) Plan Fees"
    - "Compare services received with the total cost"
    - "...Don't consider fees in a vacuum. They are only one part of the big picture, including investment risks and returns and the extent and quality of services provided. Keep in mind the importance of diversifying your investments."

Key Takeaways

- Prudently select and monitor investment options in the DC plan
  - Ensure reasonable plan fees and costs
- Review plan service providers and compare the quality of services with fees being charged
  - Consider going out to bid
- Avoid conflicts of interests and prohibited transactions
- Have a fiduciary process and procedure for making decisions and appropriate minutes
- Review SECURE Act 2.0 options to offer participants

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