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Hughes v. Northwestern University: Key Takeaways for 401(k) and 403(b) Plan Sponsors and Fiduciaries

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On January 24, 2022, the U.S. Supreme Court ruled in *Hughes v. Northwestern University* that the plaintiff-participants will get another opportunity to assert that the Northwestern retirement plan fiduciaries violated ERISA's duty of prudence based on the following: the number of investment options included on the plan menu; the decision to contract with multiple recordkeepers who put proprietary products into the plans; and the presence of investment options that were high-cost yet underperformed. The Court issued a narrow, unanimous opinion written by Justice Sotomayor (with Justice Barrett not taking part), which vacated the Seventh Circuit's decision and remanded for further proceedings so that the participants' allegations may be reevaluated as a whole.

Despite the high level of industry attention focused on this case, the Court passed on the opportunity to elaborate on what the applicable pleading standard should be for bringing a claim of fiduciary imprudence in violation of ERISA in connection with the management of a defined contribution plan. For those who have been following the developments in the 401(k) and 403(b) excessive fee space in recent years, the opinion does not provide the clarity on this key issue that some had hoped for, but it still offers lessons for plan sponsors and fiduciaries on executing their responsibilities under ERISA and a sense of how courts may construe such actions going forward.

- ***Maintaining an unusually large number of investment options on a plan menu will not absolve a fiduciary of its failure to continually monitor and remove or replace poor- performing, high-cost or otherwise imprudent investments from the menu.*** The Court concluded that the Seventh Circuit erred by focusing exclusively on the participants' ability to choose their preferred types of options from the broad and varied menu offered by Northwestern, and it said that a participant's ability to choose prudent options does not itself discharge the fiduciaries' duty to conduct an independent evaluation to determine that the inclusion of each investment option in the plan's menu is prudent. The Court also focused on the need to monitor the prudence of all previously selected investment options, in reliance on its earlier decision in *Tibble v. Edison Int'l*, 575 U. S. 523 (2015), which held, in part, that a fiduciary has a continuing obligation to monitor investments and to remove imprudent ones, separate from and in addition to the fiduciary's duty to carefully choose investments in the first instance. The Court's holding instructs sponsors and fiduciaries of 401(k) and 403(b) plans to prioritize streamlining their legacy plan menu options, and to ensure that they are regularly monitoring all of the investment options available and eliminating those that are underperforming or charging higher fees than their benchmarks without a reasonable justification for doing so. Therefore, this decision serves as a good reminder to investment committees—especially those who have taken a more laissez-faire attitude—to proactively engage their advisors and do periodic "spring cleaning" with respect to their plan lineups.

- ***Adherence to processes and procedures governing the construction and maintenance of the plan investment lineup and diligent documentation of how those processes have been followed may warrant some judicial deference.*** The opinion reaffirms the principle that a court has to look at the specific allegations and circumstances in order to determine whether the complaint plausibly alleges a breach of fiduciary standard based on keeping poorer-performing/higher-cost options in the plan lineup. The last sentence of the opinion indicates that the Court believes some level of deference to fiduciary decision-making is warranted, by acknowledging how "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 based on her experience and expertise." This guidance reaffirms the importance of having a diligent process in place for evaluating investment options and deciding when to remove certain investments as part of ongoing monitoring. Furthermore, the process that the

fiduciary undertakes and the decisions that he or she makes should be well-documented. Following these steps could help mitigate the risk of litigation in the first instance, and potentially avoid judicial second-guessing in the event that a fiduciary's actions result in a lawsuit.

- ***There may be a potential chilling effect on the ever-expanding market of retirement plan investment options.*** The Court's ruling that a plan fiduciary cannot be shielded from potential liability by ensuring the availability of some safe/prudent options in the plan lineup and relying on the participants' ability to choose could have an unfortunate impact on efforts to expand the range of investment options available to plans. As markets evolve, many plans are considering, and many participants are requesting, access to new investment opportunities, or the ability to align their retirement investments with broader values, such as through inclusion of ESG strategies or annuity options in plan lineups. Fiduciaries will need to consider the *Northwestern* opinion in analyzing how they might go about adding potentially higher-fee ESG products to plan lineups on their own merits, if they cannot rely on the availability of cheaper non-ESG alternatives on the menu as a defense to possible claims of imprudence.

If you would like to discuss the impact that the Supreme Court's decision in this case may have on any aspect of your business, or if you have other questions about 401(k) or 403(b) plan litigation risk mitigation, please reach out to any of the attorneys above.