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Mitigating Fiduciary Risk

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Discussion Overview

- Fiduciary Counseling Practice
- Lessons Learned from the Trenches
  - Investment Performance and Fees
  - Service Providers
- Case Studies:
  - *Hughes v. Northwestern University*
  - *Sacerdote v. New York University*
- Considerations regarding "3(21)" Investment Advisors vs. "3(38)" Outsourced Chief Investment Officers

Fiduciary Counseling

Fiduciary Consulting

- Identifying Fiduciary Risk
- Mitigating Fiduciary Risk
- Advising Fiduciaries, Financial Advisors, and Benefits Team on Fiduciary Concepts

Litigation Perspective:

Lessons Learned from the Trenches

Litigation Perspective

- Prudence is measured by process
  - Functioning of committee meetings
  - Interaction with investment advisors and service providers
  - Work with benefits team
- Claimants will attack any potential weakness in that process
- Documentation is key

Litigation Perspective

- Claims related to investment options
  - Performance does not justify cost
  - Availability of investment options with lower investment management fees (usually passively managed funds)
  - Share classes with lower investment management fees (e.g., retail vs. institutional shares)
  - Use of different types of investment options (e.g., collective trusts and separate accounts)
  - Underperformance compared to benchmarks and peer groups

Litigation Perspective

- Claims related to service providers
  - Recordkeepers
    - Reasonableness of fees compared to the market
    - Frequency of requests for proposals
    - Indirect payments (e.g., through revenue sharing)
    - Conflicts of interest
    - Use of participant data for marketing additional services
  - Investment consultants
    - Quality of investment advice
    - Monitoring the services of consultants

Litigation Perspective

- Defenses to claims about investment options
  - No need to "scour the market" for the cheapest possible option
  - Fiduciaries may select and retain funds for reasons other than cost
  - Lack of viable benchmarks to measure alleged underperformance and/or cost
  - Underperformance claims based on self-serving data with the vantage of hindsight
  - No requirement under ERISA that fiduciaries offer any particular type of investment option

Litigation Perspective

- Defenses to claims about investment options
  - Committee's process was prudent
    - Regular meetings
    - Review and understanding of investment materials
    - Active and engaged members
    - Consideration of alternative investments
    - Familiarity with plan documents
    - Consistency with investment policy statements and committee charters and/or bylaws
  - Process defenses will usually require some amount of discovery (fact and expert)

Litigation Perspective

- Defenses to service provider claims
  - Recordkeepers
    - Cannot compare fees in a vacuum given the varied services provided for different plans (i.e., lack of viable benchmarks)
    - Monitoring of fees (including indirect fees)
    - Direct payment by plan sponsor
    - Review of service agreements to protect participants' best interests (e.g., use of participant data)
    - Active engagement to ensure fees are reasonable (RFPs, RFIs, or contract negotiation)
  - Investment consultants
    - Monitor advice and performance

Litigation Perspective

- Case Study: *Hughes v. Northwestern University*
  - Supreme Court granted certiorari
  - Plaintiffs and Solicitor General focus on:
    - Recordkeeping structure and costs
    - Retail vs. Institutional Share Investments
    - Inclusion of Passive Funds
  - What could this mean for fee litigation going forward?

Litigation Perspective

- Case Study: *Sacerdote v. New York University*
  - Reversal of a portion of the decision
  - Retail vs. Institutional Share Class
    - Does a difference in price based on revenue sharing save fiduciaries of claims that they could have selected lower cost funds?
    - If two funds are identical for all reasons other than price, does it make the cheaper fund objectively reasonable?
  - Loss Causation

Litigation Perspective

- Case Study: *Sacerdote v. New York University*
  - Focus on individual committee member defendants
  - Certain testimony by committee members was "troubling"
  - Can individual committee members breach their duties of prudence when the committee's functioning overall was reasonable?

Litigation Perspective

- Fiduciary Best Practices:
  - Hold active and engaged committee meetings at least 2-3 times per year (preferably quarterly)
  - Consider alternative investments, including different share classes of existing options, or other types of investments
  - Review and understand investment materials, and ask questions of investment consultants and other committee members
  - Act on prudent advice from investment consultants, but know that fiduciaries must make informed decisions independently
  - Investigate service provider fees, particularly for recordkeepers, to ensure they are competitive (including with RFPs or RFIs)
  - Document everything to memorialize your best practices

Investment Advisors vs. Outsourced Chief Investment Officers (OCIOs)

Investment Advisors vs. OCIOs

- Section 3(21) investment advisors
  - What is the responsibility of the investment advisor?
  - What are the responsibilities of the plan fiduciaries?

- Section 3(38) outsourced chief investment officers ("OCIOs")
  - What is the responsibility of the outsourced chief investment officer?
  - What are the responsibilities of the plan fiduciaries?

Investment Advisors vs. OCIOs

- Considerations when deciding to retain an outsourced chief investment officer
  - Fiduciary duties when selecting an OCIO
  - Transitioning from an investment advisor to an OCIO
  - Assumption of litigation risk

Investment Advisors vs. OCIOs

- Potential obstacles
  - Limitations on discretion for investment decisions
  - Mutual funds vs. other types of investments
  - Decisions regarding certain types of investments may force reversion back to "3(21)" status where plan fiduciaries must approve those decisions based on recommendations (e.g., decisions involving plan assets invested in collective trusts or separate accounts)
- Who is responsible for investment decisions?

Investment Advisors vs. OCIOs

- Fiduciary duties to monitor OCIO should consider:
  - Professionals who are servicing account
  - OCIO’s internal governance
  - Fiduciary or investment committees
  - Investment manager research capabilities
  - Timely delivery of reports and compliance oversight
  - Performance targets and fees
  - Adherence to investment policy
  - Written delegation of fiduciary/investment authority

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