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Legal Sidebar

Supreme Court Rules on Retirement Plan Fiduciary Duty in *Hughes v. Northwestern University*

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Among Congress's policy priorities is safeguarding retirement income security for working Americans, retirees, and their families. In January 2022, the Supreme Court issued its decision in *Hughes v. Northwestern University*, a case concerning a plan fiduciary's duty to control retirement plan fees and manage a plan's investment lineup under the Employee Retirement Income Security Act (ERISA), and the circumstances under which participants and others may sue fiduciaries for a breach of these duties. In *Hughes*, the Court emphasized that as part of these duties, plan fiduciaries must continuously monitor plan investments and remove imprudent investments from the plan, even if the plan offers an extensive range of investments. This Legal Sidebar provides background on ERISA's requirements for retirement plans and plan fiduciaries; discusses the Court's decision in *Hughes*; and concludes with select considerations for Congress.

Background

ERISA provides a comprehensive federal scheme for regulating private-sector employee benefit plans. The Act governs roughly 733,000 retirement plans that contain more than $10 trillion in plan assets. ERISA does not require employers to offer retirement benefits, but those that do must comply with the Act's requirements.

The *Hughes* case involved a so-called 403(b) plan, a 401(k)-like defined contribution plan used by certain educational institutions and tax-exempt organizations. As part of this retirement plan type, each participant has an individual account containing an amount based on employer and employee contributions and investment gains or losses to the account, minus fees or other plan expenses. Defined contribution plans do not provide a guaranteed benefit amount, and participants' account balances generally fluctuate over time. Plan fiduciaries typically compile a menu of investment choices, and plan participants select investments from this menu.

One of ERISA's central goals is to "protect . . . the interests of participants and . . . beneficiaries" of employee benefit plans. To this end, ERISA imposes certain obligations on plan fiduciaries—persons who

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generally have discretionary authority or control over the management and operation of employee benefit plans. Among these obligations, ERISA requires fiduciaries to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man . . . would use in the conduct of an enterprise of a like character and with like aims." When determining whether a fiduciary has violated the duty of prudence, courts commonly look to the fiduciary's conduct surrounding the selection and acquisition of a particular investment, rather than an investment's ultimate performance.

ERISA fiduciaries must also manage plan expenses that plan participants pay. While the Act does not specify a level of fees that may be paid through a defined contribution plan participant's account, fiduciaries must ensure that plan fees are "reasonable." Additionally, under ERISA, participants and government entities can bring various civil actions to enforce the Act's fiduciary requirements. Among other provisions, the Act authorizes the Secretary of Labor, a plan participant, and others to bring a civil action to redress a breach of fiduciary duty. ERISA makes a plan fiduciary personally liable for breaches against a plan.

Recently, there has been extensive litigation over whether defined contribution plan fiduciaries imprudently selected or failed to monitor plan investments with "excessive fees" that underperformed alternative, lower-priced investments. Excessive fee litigation has also involved legal challenges relating to plan service providers and claims that fiduciaries improperly paid exorbitant amounts to providers to administer 401(k) or other defined contribution plan benefits. In these cases, plan participants have alleged that plan fiduciaries breached their duties by paying unnecessarily high recordkeeping and/or investment management fees and expenses, which substantially lowered the participants' retirement account balances. Dozens of fee-related cases were filed in recent years, and some litigating parties have reached multimillion dollar settlements. Beginning around 2016, there has been a swell of excessive fee litigation involving 403(b) plans in particular. Several lawsuits have been filed against universities on behalf of thousands of plan participants.

Hughes v. Northwestern University

In *Hughes* (formerly captioned *Divane v. Northwestern University*), employees participating in at least one of the University's two 403(b) plans filed a class action lawsuit against the educational institution and certain university officials, claiming that plan fiduciaries imprudently paid excessive recordkeeping and investment management fees. Given that the plans jointly held more than $3 billion in net assets, participants generally contended that plan fiduciaries failed to employ certain methods available to larger plans to reduce plan expenses. Plan participants alleged that the fiduciaries breached their obligations by, among other things, imprudently choosing investment options with "unnecessary" management fees in the plans' investment lineup. In particular, participants challenged the fiduciaries' selection of certain "retail-class" mutual funds, when identical "institutional class" fund shares were available to large investors at lower prices. Plan participants also asserted that there were an excessive number of plan investment offerings, causing needless confusion and difficulty for participants in making investment selections.

The district court dismissed participants' claims for failing to demonstrate a plausible ERISA violation, and the U.S. Court of Appeals for the Seventh Circuit affirmed the judgment. The appeals court indicated that the participants had the opportunity to keep expenses low by choosing to invest in certain low-cost index funds that were also available under the plan, and were not "forced to stomach an unappetizing menu." The Seventh Circuit concluded that, in concert with earlier Seventh Circuit decisions, plans could offer a broad range of investment options and fees without breaching fiduciary responsibilities under ERISA.

In an 8-0 decision written by Justice Sonia Sotomayor, the Supreme Court concluded that the Seventh Circuit's analysis fell short. (Justice Amy Coney Barrett did not participate in the consideration or decision in the case.) Relying on its earlier decision in *Tibble v. Edison International*, the Court explained that the problem with the Seventh Circuit's reasoning was its singular focus on the idea that participants had a diverse range of investment options in the plan, and that "investor choice" excused fiduciaries from a possible breach of their duties. The Court further determined that the Seventh Circuit did not undertake the requisite "context-specific inquiry" concerning the fiduciaries' duty to monitor plan investments and remove imprudent investment options from the plan's menu. As the Court indicated, failure to eliminate poor investments from a retirement plan within a reasonable time constitutes a breach of fiduciary duty under ERISA. The Court vacated the Seventh Circuit's decision and remanded the case for further review.

Considerations for Congress

While the practical impact of *Hughes* remains to be seen, the decision may be notable because it highlights two main points with respect to ERISA fiduciary liability. First, as the Supreme Court articulated, retirement plan fiduciaries cannot satisfy ERISA's duty of prudence solely by offering an array of plan investment options beyond the products associated with allegedly excessive fees. Additionally, to meet the duty of prudence, plan fiduciaries have an ongoing responsibility to monitor plan investments and weed out imprudent investments from a plan's investment portfolio.

The Court also left open a number of issues in *Hughes*. For instance, the Court did not weigh in on whether the disputed retail-class investments in the retirement plans were suitable for participants, nor did the Court articulate criteria for making that determination. However, the Court recognized that ERISA fiduciary liability is context-dependent, and wrote that "[a]t times, 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 statement arguably signals that in the Court's view, lower courts should afford some leeway to plan fiduciaries in evaluating whether a fiduciary made a prudent investment decision.

Should Congress decide to address the issue of plan fiduciary obligations, it could consider further defining the scope of these obligations in legislation, including with respect to how fiduciaries should evaluate the level of fees associated with a particular investment. Alternatively, Congress could explore legislation that addresses a plan participant's burden of proof for bringing a viable claim against a plan fiduciary relating to alleged excessive fees. Such legislation could also alter the ability of plan participants to raise claims in these types of cases.

Author Information

Jennifer A. Staman
Legislative Attorney

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