The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 32148

January 16, 2020

Supreme Court Declines to Hear 401(k) Fee Case

[32148]

January 16, 2020 TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: Supreme Court Declines to Hear 401(k) Fee Case

Yesterday, the US Supreme Court officially denied certiorari in *Putnam Investments, LLC v. Brotherston*.[1] ICI had previously filed an amicus brief in this case, supporting the certiorari request and urging the US Supreme Court to grant certiorari and reverse the lower court's decision in the case.[2]

Background

The *Brotherston* case was the first to go to trial of several class-action lawsuits filed against mutual fund families and focused on the inclusion of proprietary fund products in the 401(k) plans they sponsor for their employees. The plaintiffs (former Putnam employees) alleged that Putnam breached its fiduciary duty by including proprietary fund products in its 401(k) plan.[3] In addition to claiming that Putnam's decision-making was inadequate regarding the investments offered, plaintiffs calculated a loss to the plan, determined by comparing the investment returns and fees of the Putnum funds offered in the plan against a hypothetical lineup of only index funds.

On appeal of the district court's dismissal of the case,[4] the First Circuit held that plaintiffs' comparison of the plan's fund lineup against index funds was sufficient to show there was a loss to the plan.[5] It then ruled that "once an ERISA plaintiff has shown a breach of fiduciary duty and loss to the plan, the burden shifts to the fiduciary to prove that such loss was not caused by its breach." The court opined that its decision would not increase plan fiduciaries' burden because a fiduciary "can easily insulate itself" by selecting index funds instead of actively managed funds. In applying this burden-shifting approach, the First Circuit deepened an existing circuit split, leading Putnam to petition for certiorari. More specifically, Putnam requested that the US Supreme Court consider two issues:

1. Whether an ERISA plaintiff bears the burden of proving that "losses to the plan result[ed] from" a fiduciary breach, or whether ERISA defendants bear the burden of dis-proving loss causation.
2. Whether evidence that a plan's actual investment options did not perform as well as a

set of index funds, selected by the plaintiffs with the benefit of hindsight, suffices as a matter of law to establish "losses to the plan."

ICI's Amicus Brief

In its amicus brief, ICI noted that shifting the burden of proving causation, or the lack thereof, from the plaintiff to the fiduciary ignores the ordinary default rule and the plain language of ERISA specifying that fiduciaries are liable for "losses to the plan resulting from" a fiduciary breach. "The ruling will inevitably adversely skew fiduciaries' selection decisions. Congress directed fiduciaries to make investment option selections in the best interests of participants. Participants' best interests vary based on many factors, including individual needs (e.g., age, marital and family status, other financial resources, risk appetite, and other factors) and the marketplace, so fiduciaries typically make available to plan participants a wide range of options. The ruling gives fiduciaries greater—and potentially overwhelming—incentives to make choices driven by the threat of litigation based on a single point of reference (i.e., index funds), rather than simply by what plan participants' best interests dictate," the brief explains.

ICI also argued that allowing plaintiffs in ERISA fiduciary-breach cases to meet the loss causation element of a fiduciary breach claim solely by comparison to an index-fund-only hypothetical ignores the differences between actively managed investments and index funds as well as their differing benefits for participants while assuming that, as a per se matter, a prudent fiduciary would necessarily substitute passively managed funds for active ones no matter the circumstances.

ICI added that "[b]oth aspects of this decision threaten to harm virtually all stakeholders in the marketplace for retirement planning products. The First Circuit's ruling creates an incentive for plan fiduciaries to make available certain options and not others, to the detriment of plans, participants, sponsors, and fiduciaries." ICI explained that the burden-shifting framework adopted by the First Circuit will only increase the frequency of ERISA litigation that is already on the rise because plaintiffs who have to prove one less element of a case have more incentive to bring the case in the first place. In addition, ICI continued that if the First Circuit's ruling that comparisons between a plan's investment options and a hypothetical lineup of only index funds to prove that a loss occurred is left standing, fiduciaries may offer only index funds to avoid litigation. The brief notes that "[t]his disregards the nuances of constructing an investment lineup that serves the best interests of a broad array of plan participants."

Solicitor General's Brief

In April 2019, the Supreme Court invited the Solicitor General to file a brief in the case expressing the government's view. In response, in November 2019, the Solicitor General submitted an amicus brief, opining that the certiorari petition should be denied on both questions presented. The Solicitor General maintained that the First Circuit "correctly decided both questions." Further, regarding question one above, he argued that "this case would be a poor vehicle" to resolve the question because of its intermediate stage of the case. Regarding question two, the Solicitor General argued that the "selection of comparator funds largely depends on the facts and circumstances of the case."

In December, Putnam filed a supplemental brief addressing the position taken by the Solicitor General. Putnam countered that the issue should be resolved now, the posture of the case is ideal because the burden allocation was case-dispositive, and the Solicitor General's position is self-interested and should be rejected. Unfortunately, the Supreme Court was not persuaded by the brief and declined to grant certiorari.

We are disappointed in the Supreme Court's decision but will continue to seek needed clarification in this critical area.

Shannon Salinas
Assistant General Counsel - Retirement Policy

endnotes

[1] *Putnam Inv., LLC v. Brotherston*, U.S., No. 18-926; appealed from *Brotherston v. Putnam Inv., LLC*, No. 17-1711 (1st Cir. 2018).

[2] *See* ICI Memorandum No. 31621, dated February 21, 2019, *available at* https://www.ici.org/my_ici/memorandum/memo31621.

[3] Although plaintiffs criticize the fact that Putnam made proprietary funds available in the plan, it is important to note that plaintiffs had a wide menu of options from which to choose, including index funds. Putnam's 401(k) investment menu included nearly all of the open-end mutual funds managed by Putnam that were generally made available to other employers' retirement plans, as well as passively managed index CITs managed by a Putnam affiliate and a brokerage window through which participants could invest in thousands of unaffiliated funds.

[4] The district court held that plaintiffs failed to identify any specific circumstance in which Putnam and its 401(k) plan put their own interests ahead of plan participants and failed to show that Putnam's actions resulted in losses to the plan. The First Circuit vacated the district court decision (in part) and remanded the case back to district court, instructing the lower court to reconsider the case by applying the First Circuit's rules on burden shifting and loss causation.

[5] ICI had previously filed an amicus brief at the circuit court level. *See* ICI Memorandum No. 31059, dated January 29, 2018, *available at* https://www.ici.org/my_ici/memorandum/memo31059.