Wildman vs. American Century – Process Saved the Day

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On June 30, 2016, a class action complaint[1] was filed by Steve Wadman, et al (Plaintiffs), against American Century Retirement Plan ("Plan"), the Plan Sponsor and the Plan Committee (collectively the Defendants). On January 23, 2019, Chief Judge Greg Kays, issued a finding of facts and conclusion of law[2] and dismissed all counts in favor of Defendants.

BACKGROUND

1. Investment Options

The Plan's 33 to 46 diverse array of investment options are made up of American Century mutual funds, collective investment trusts, Company's Class C common stock, and a self-directed brokerage account ("SDBA"). The SDBA made available proprietary and non-proprietary investment options including index mutual funds, exchange traded funds, and individual stocks and bonds.

The Plan offered institutional share class funds starting June 30, 2010, and in August 2014, retirement share class R6 funds (lower cost) replaced the institutional shares. On September 12, 2016, the Committee added 5 Vanguard index funds to the Plan's investment lineup.

The Committee believed actively managed funds were more responsive to market fluctuations. It also recognized that active funds tend to have higher fees than passive funds but deemed the benefits outweighed those costs. Further, the Committee believed Plan participants preferred actively managed funds, given the employees' enthusiasm for American Century and their unique access to fund managers for ongoing monitoring and assessment.

2. Recordkeeping & Revenue Sharing

In December 2013, Schwab RPS replaced JPM RPS as the new recordkeeper resulting from an independent consultant RFP process. The Defendant paid the Plan's recordkeeping costs regardless of the fee arrangement or the recordkeeper. In 2018, Schwab RPS told American Century that it was possible to rebate revenue sharing back to the participants, and the Committee elected to do so.

[1] https://s3.amazonaws.com/si-interactive/prod/planadviser-com/wp-content/uploads/2017/09/19165951/WildmanvAmericanCenturyServicesComplaint.pdf
[2] https://www.napa-net.org/wp-content/uploads/American-Century-dismissal.pdf

3. Plan Process & Investment Policy Statement (IPS)

Committee members received training and information about their fiduciary duties, including a "Fiduciary Toolkit," which outlined their duties as fiduciaries, as well as a summary plan document, and articles regarding fiduciary duties in general. The materials also included a copy of the current Investment Policy Statement ("IPS"). The IPS provides that the Plan invest in affiliated funds only to the extent that mutual funds and other investment products offered by American Century meet the criteria for investment selection. Specifically, the investment selection criteria included the following:

(A) Performance should be equal to or greater than the median return for an appropriate, style-specific benchmark or peer group over a specified period of time.
(B) It should demonstrate adherence to the stated investment objective.
(C) Fees should be competitive compared to similar investments.
(D) The investment manager should be able to provide all performance, holding, and other relevant information in a timely fashion, with specified frequency.
(E) It should have the potential to occupy a defined role within a well-diversified asset allocation plan. It should fill a need in giving participants the opportunity to construct a suitable, well diversified investment portfolio with regards to diverse asset class exposure, market capitalization, style orientation, growth, income needs and risk management.
(F) It should complement, not copy, existing Core Investment Options.

The IPS provided the Committee with broad discretion, which allowed members to use their investment expertise to determine whether a fund's long-term performance goals could still be achieved despite its underperformance over a specified period. The Committee believed that mandated removal of investments that underperformed their benchmarks would be undesirable in that it would always require removing a fund at its low point, incurring a loss, and preventing participants from taking advantage of any subsequent improved performance.

The Committee was very active and reviewed presentations from Committee members regarding the investment options available under the Plan's core lineup and potential core investment options. At times during meetings, the Committee reviewed presentations from consultants who presented findings from their research and lawyers provided information relevant to the Committee's work. The Committee also asked investment professionals to present information on a fund, especially when a fund was underperforming, including those on the "Watch List[3]".

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[3] The Watch List criterion was driven by a fund's information ratio, which measures a fund's risk adjusted return. If a fund's one-year and three-year information ratios were less than -0.5, a fund was placed on the Watch List. To be removed from the Watch List, a fund needed to perform better than the bottom quartile for two quarters in the one-year category.

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The Committee meetings were documented through a set of meeting minutes. The meeting minutes were thorough, capturing the topic of discussion, who initiated questioning, and then the outcome of the vote or the Committee's ultimate decision.

4. *Investment Fee Monitoring*

From 2010 until 2013, the Committee received and reviewed a report that compared each fund in the core lineup against the fees of funds within its Lipper peer group. The Committee obtained similar materials from Schwab starting in 2014; the materials reported each fund's expense ratio and compared that expense ratio to mutual funds in the same category. From 2017 on, the Committee received and studied reports prepared by another consultant which compared each fund's expense ratio to the median expense ratio of the funds within the fund's Morningstar category.

CONCLUSION OF LAW

The Plaintiff pursued three counts at trial:

1. *Breach of fiduciary duty, in violation of 29 U.S.C. § 1104(a)(1)(A)-(B)*

Plaintiff bears the burden of showing the Defendant breached its fiduciary duties. Plaintiff must prove, by a preponderance of evidence, that:

(A) the Defendant is a fiduciary,
(B) the Defendant breached its fiduciary duty and
(C) that breach caused a loss to the Plan.

If and once this burden is satisfied, the "burden of persuasion" shifts to the Defendant to show that a prudent fiduciary, under the same circumstances, would have made the same decision.

Duty of Loyalty & Duty of Prudence

The fiduciary duty in question is comprised of the duty of loyalty ("solely in the interest of") and the duty of prudence.

The duty of loyalty is analyzed under a **subjective** standard where "what matters is why the defendant acted as he did."[4] This means the test focuses on the reason a fiduciary took the challenged action and whether it was motivated by "subjective good faith." ERISA does not prohibit an employer's corporate officers or employees from serving as plan fiduciaries, but it requires such individuals "wear the fiduciary hat when making fiduciary decisions." A conflict of interest alone is not a per se breach; nowhere in ERISA does it explicitly prohibit a trustee from holding positions of dual loyalty. Furthermore, it is not disloyal, as a matter of law, to offer only proprietary funds.

[4] Wells Fargo ERISA 401(k) Litig., No. 16-CV-3405 (PJS/BRT), 2018 WL 3475485vs.

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Duty of Prudence

According to the Eighth Circuit (Braden v. Wal-Mart Stores Inc., 588 F.3d 585, 598. 2009), the duty of prudence is outlined as follows:

> *The statute's "prudent person standard is an objective standard ... that focuses on the fiduciary's conduct preceding the challenged decision." In evaluating whether a fiduciary has acted prudently, we therefore focus on the process by which it makes its decisions rather than the results of those decisions.*

Duty of prudence is context specific as it is based on the circumstances then prevailing. The Committee is expected to consider all relevant information in performing its fiduciary duty under ERISA. Courts have readily determined that fiduciaries who act reasonably would have satisfied this requirement. However, even if a fiduciary failed to conduct an investigation before making a decision, the fiduciary is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway[5]. In addition:

(A) a fiduciary of an asset manager plan sponsor is not required to consider competitors' funds if the proprietary funds chosen in the plan are prudent options;
(B) the law does not require the selection process to consider all funds from every investment manager and then winnow the funds down to the very best-performing one;
(C) ERISA does not require a retirement plan to offer an index fund or a stable value fund, and the failure to include either in the Plan, standing alone, does not violate the duty of prudence;
(D) the Committee has demonstrated with overwhelming evidence that it has given appropriate consideration for adding stable value funds and index funds and has considered the benefits and detriments of adding these options;
(E) sector funds carry with them inherent risk, but it does not mean that offering them in a menu was imprudent;
(F) the Committee thoroughly discussed the composition of the Plan's lineup to ensure it covered the entire risk/reward spectrum without duplication; while the Plan offered a large number of investment options to participants, it was certainly not imprudent to do so, given the sophisticated investor base of the Plan participants;
(G) the Committee followed a prudent process in monitoring and retaining funds in the Plan, and noting that removing funds from the Plan was very disruptive to Plan participants, the Committee was hesitant to remove a fund simply because it had not performed well in the short term;
(H) fees, like performance, cannot be analyzed in a vacuum[6], like a fund's rate of return, a fund's fee is only relevant in so far as it demonstrates the Committee's decision-making process was imprudent; and

[5] Tatum v. RJR Pension Inv,. Comm., 761 F.3rd 346, 358 (4th Cir. 2014)
[6] Meiners, 2017 WL 2303968

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(I) delaying the switch from the higher fee share class when the lower fee share class became available was not imprudent since the conversion was completed on an as-soon-as-practicable basis based on then circumstances.

Defendants prevailed on this first claim.

2. Failure to monitor fiduciaries

The duty to monitor is wholly derivative of the first claim: a breach of fiduciary duty, and a derivative claim, such as a claim alleging a breach of the duty to monitor, cannot survive without an underlying fiduciary breach[7].

Defendants prevailed on this second claim.

3. Equitable disgorgement of ill-gotten profits, pursuant to 29 U.S.C. § 1132(a)(3)

The plaintiffs cannot prevail unless the breach of fiduciary duty either imposed a loss on the plan or generated a profit for the Defendants. This claim is contingent on the Court finding Defendants breached their fiduciary duties to the Plan, but the Court found Defendants did not breach any fiduciary duty.

Defendants prevailed on this third claim.

CONCLUSION

This class action lawsuit shows that good and well documented fiduciary practices are the core strength of the defense.

The Duty of Loyalty is subjective and requires fiduciaries to act solely in the interests of the plan participants and beneficiaries. Even if fiduciaries are in conflicting roles, as long as they can demonstrate that they have not placed their or others' interests ahead of the Plan's interests, they have met this duty of loyalty. This requires the fiduciary to know its participants and beneficiaries so that the plan can be designed, and investments offered to align with their makeup.

The Duty of Prudence is built on the Duty of Loyalty, and it is objective and facts and circumstance based. Prudence is evidenced by the existence of a process: a clear, written, well-followed process. However, prudence is not static and is a part of the deliberative process which is subject to change based on new inputs and incoming facts.

[7] Roe v. Arch Coal, Inc., No. 4:15-CV-910 (CEJ), 2017 WL 3333928, at *5 (E.D. Mo. Aug. 4, 2017)

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This case has dispelled the increasing beliefs that: lowest cost by the way of index investments is equivalent to a fiduciary safety net when compared to higher cost active alternatives; a higher yielding stable value fund is a better fiduciary option; or an investment on a Watch List for an extended period time without removal is imprudent. Meeting the fiduciary standard requires plan fiduciaries to inquire, collect, investigate, discuss, debate, and make informed decisions. The fiduciary decision is ex post and therefore is evaluated based on the circumstances then prevailing, and ex ante evidence should not be employed in judging fiduciary prudence. Therefore, the ongoing process of monitoring affords fiduciaries the timeliness to make adjustment in order to maintain an adaptive process. Fiduciary duty is about a prudent process (ex post) and not optimal outcomes (ex ante).

Retirement fiduciaries owe American Century a debt of gratitude for staying the course until the court rendered its opinion and judgement. Far too often, plan sponsors settle with plaintiffs privately out of court and the industry is not afforded caselaw (and precedents) to better inform fiduciary conducts and dispel facts from fiction.

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