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Wanek v. Russell Investments Trust Company

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The District Court of Nevada issued an Order regarding Defendants' Motion for Summary Judgment in Wanek v. Russell Investments Trust Company. The participants sued Caesars Holding, Inc. and Russell Investments, a 3(38) Discretionary Investment Manager hired by Caesars'.

First and foremost, advisors acting in a 3(38) capacity should take heed, you are in the crosshairs of the plaintiff bar for your investment decisions. Second, Caesars was dismissed as a matter of law because they:

1. Prudently delegated investment discretion to Russell after an independent consultant conducted a Request for Proposal ("RFP") Advisor search. The court noted the RFP demonstrated a prudent process that evaluated multiple qualified finalists.
2. In addition, the documentation demonstrated Caesar's negotiated fees, obtained and reviewed quarterly monitoring reports, maintained meeting minutes, and strictly adhered to the Investment Policy Statement ("IPS ") requirements.

For these reasons, the court found Caesars was not liable for Russell's discretionary investment decisions even though the plaintiffs argued Russell's Target Date Funds ("TDFs") performed poorly. This case adds credence that employers escape liability for investment performance when a prudent process is adopted to secure an ERISA 3(38) Advisor and the Court's decision is consistent with ERISA construct which focuses on evaluating process not outcomes.

It is worth mentioning the Court apparently felt comfortable knowing Caesars retained an independent third-party consultant to conduct an RFP to search for an ERISA 3(38) advisor not that an RFP or retaining an independent third-party to conduct the search is an ERISA requirement. We do not know how or if the Court would rule differently had Caesars hired Russell without retaining a third-party consultant or conducting an RFP.

The Court also offered an insightful response to the plaintiff's poor performance claim by referencing the IPS which included a provision that investments would be evaluated over a full market cycle which was defined as 5 years in the IPS. Russell's custom TDFs had only been in place for 4 years; therefore, to rule against Caesars would, in essence, indicate the Court prematurely overrides a proper and prudent delegation of investment responsibility to Russell who was consistently monitored with full documentation. This is a key take away for advisors, and it merits advisor consideration to incorporate similar wording in the IPS when custom funds or any fund is offered with less than 5 years of history.

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Although the suit against Caesars is dismissed, it will continue against Russell. The continuation is not tied to a claim that Russell received unreasonable compensation by implementing their proprietary TDFs. Instead, the suit continues against Russell because Russell's decision to use their proprietary TDFs is allegedly a violation of loyalty and prudence. Therein lies another lesson for all 3(38)s that are interested in offering custom TDFs.

The Court's key findings revealed Russell urgently needed Assets Under Management ("AUM") in its proprietary TDFs and Caesars' retirement plan represented 70% of the TDF AUM. Losing Caesars arguably could result in the demise of Russell's proprietary TDFs due to a lack of assets to keep the TDFs afloat. Herein lies the lesson for a 3(38). If your custom TDFs rely on a single client's assets to justify continuing the existence of the custom TDF investment strategy, you could be subject to a claim of imprudence and disloyalty. Your recommendation for any investment must not be influenced by your desire to stabilize your investment strategy. In other words, it is not about you, it is all about the participants.

In time we will learn the ultimate decision of the court. In the meantime, any advisor offering 3(38) services should take into consideration the lessons learned from this case thus far.

1. Hiring a 3(38) should be accomplished through a well-documented formal process.
2. If that process includes a formal RFP by an independent third party with no opportunity to become the 3(38) all the better since this approach holds weight with the Court.
3. Engaging in an ongoing documented monitoring process is key to defending the plan sponsor when performance is attacked by a plaintiff.
4. Including wording in your IPS that "all investments will be monitored over a full market cycle defined as 5 years" is a good risk mitigation strategy for existing investments and investments with less than 5 years of history, especially custom designed investments.
5. A 3(38) should never choose a proprietary investment if investor dollars are needed to keep the proprietary fund active. It can be construed as a desperate attempt to save your pride and argued it was an act of disloyalty and imprudence.

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