No. 17–1515

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

MARY BARCHOCK; THOMAS WASECKO; and STACY WELLER,

Plaintiffs -Appellants,

v.

CVS HEALTH CORP.; THE BENEFITS PLAN COMMITTEE OF CVS HEALTH CORP.; and GALLIARD CAPITAL MANAGEMENT, INC.,

Defendants -Appellees.

On Appeal from
The U.S. District Court for the District of Rhode Island
No. 1:16-cv-00061-ML-PAS

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF APPELLEES AND AFFIRMANCE

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STATEMENT OF THE IDENTITY AND INTEREST OF THE AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association (SIFMA) is the voice of the U.S. securities industry. SIFMA represents the broker-dealers, banks, and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the United States, serving clients with over $20 trillion in assets, and managing more than $67 trillion in assets for individual and institutional clients, including mutual funds and retirement plans. SIFMA has offices in New York and Washington, D.C., and is the regional member of the Global Financial Markets Association for the United States. Additional information about SIFMA is available at http://www.sifma.org.

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[1] Pursuant to Fed. R. App. P. 29(a)(4)(E), no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and no person—other than the amicus curiae, its members, or its counsel—contributed money that was intended to fund preparing or submitting the brief.

Pursuant to Rule 29(a)(4)(D), this brief is accompanied by a motion for leave to file.

Virtually all companies that offer participant-directed retirement plans permit their participants to elect an income-producing, low risk, liquid fund, such as a money market fund or a stable value fund. SIFMA members manage such funds, and also offer them in the defined-contribution plans that they sponsor and administer for their employees.

The rise in the use of defined contribution plans has spawned a rise in lawsuits like this one, in which participants allege that plan fiduciaries or plan service providers breached their respective duties to plan participants by including investment options that proved, with the benefit of hindsight, to be too risky—or not risky enough. Decision makers for defined contribution plans must make their decisions, however, before it is known how the investment markets will fare.

SIFMA has a strong interest, on behalf of its members, in clarifying the fiduciary obligations of investment managers and plan fiduciaries in selecting and managing investment options in retirement plans governed by ERISA.

ARGUMENT

When asset managers decide how to manage their portfolios, they do not know how the markets will perform. They do not know whether, in the coming years, the markets will reward or punish risk-taking in any particular market segment. Even the most sophisticated asset managers cannot reliably predict which sectors will thrive and which will falter—or when the market has reached its apex or its trough. At the point of decision, uncertainty reigns.

As a result, sound investment management requires risk management. Investment professionals develop and implement processes for scrutinizing assets before selecting them for their portfolios. The objective is to formulate a portfolio with a chosen risk profile that provides opportunities for returns concomitant with that level of risk.

In this case, three participants in the 401(k) Plan and Employee Stock Ownership Plan of CVS Health Corporation and Affiliated Companies (the "Plan") are challenging the Plan's Stable Value Fund. As the name suggests, a stable value fund is a conservative investment option that is designed to provide stability, as opposed to growth. Plaintiffs do not claim that the Stable Value

Fund lacked stability, nor that it failed to maintain its value. Rather, their theory is that ERISA required the Stable Value Fund to be invested in riskier, longer-term assets in pursuit of greater yield.

Plaintiffs' thesis—if endorsed by a court—would prove deeply problematic to the financial services industry and to the ERISA plans that it serves. With the benefit of hindsight, it will always be possible to observe that, during any given period, more risk in particular segments was either rewarded or punished. At the point of decision, however, asset managers lack the benefit of hindsight. Instead, asset managers and ERISA fiduciaries must rely on sound processes to offer plan participants the opportunity to elect a specified tradeoff between risk and possible reward. Courts have rightly refused to entertain claims, like this one, that rely, inextricably, on hindsight.

In the end, given the lack of any meaningful allegation that there was a deficiency in the process for managing the Stable Value Fund, Plaintiffs' complaint amounts to nothing more than the claim that the Stable Value Fund should have looked more like some "average" stable value fund. But ERISA permits—indeed,

encourages—fiduciaries to make their own decisions about whether, in any given market segment, they want an average level of risk, or a below- or above-average level of risk, based on their own judgments and on the specific circumstances of their own participants. ERISA permits fiduciaries to choose a stable value fund—or any other type of fund—with a below-average level of risk. Those same fiduciaries cannot later be subjected to liability because that below-average level of risk yielded a lower return than a fund that took on more risk. Nor can the investment manager be subjected to liability for offering such a fund.

I. ASSET MANAGEMENT MUST BE JUDGED BY PROCESS, NOT HINDSIGHT.

A. Hindsight can play no role in the assessment of asset management.

The financial markets are, by their nature, unpredictable. "While it is easy to pick an investment option in retrospect (buy Apple Inc. at $7 a share in December 2000 and short Enron Corp. at $90 a share), selecting an investment beforehand is difficult." *Tussey v. ABB, Inc.*, 746 F.3d 327, 338 (8th Cir. 2014). The same holds true for investment risks generally. In hindsight, it is easy to discount low probabilities of catastrophic events that did not occur

(or to take for granted low probability events that did occur). But accurately projecting uncertain events beforehand is hard.

Indeed, their lack of predictability is what makes the markets function. Investors demand a premium for taking on risk, so the market prices bonds and stocks based on expectations for their future value combined with the likelihood that the expectations will be realized.

In that environment of uncertainty, asset managers employ techniques to manage risks. They assemble portfolios to achieve targets for risk and projected return and monitor the portfolios to ensure continued compliance with those objectives. This approach permits asset managers to offer investors the opportunity to participate in a particular risk-return tradeoff. But, in any given market environment, some strategies will outpace targets, while others will fall short.

In aggregate, it is an unavoidable fact of mathematics that half of all funds will underperform the median, with one-in-four in the bottom quartile. ERISA plaintiffs are frequently tempted by that truism to engage in condemnation-by-comparison. As the argument runs, the fact that other investments fared better over

some (arbitrary) time period shows that the challenged investments were flawed.[2]

If this reasoning were enough to state an ERISA claim, it would be a foolproof way to generate an unending supply of cases from the Nation's 500,000 401(k) plans.[3] With the benefit of hindsight, a plaintiff can easily identify the quarter of funds with returns in the bottom quartile, and then identify the investment decisions that most contributed to their lower returns. There is nothing to distinguish the present case from any other case that could be brought via the same hindsight selection algorithm.

Accordingly, with good reason, courts have emphasized that ERISA's "fiduciary duty of care . . . requires prudence, not prescience." *DeBruyne v. Equitable Life Assurance Soc'y of the U.S.*, 920 F.2d 457, 465 (7th Cir. 1990) (internal quotation marks omitted); *accord Rinehart v. Lehman Bros. Holdings Inc.*, 817 F.3d

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[2] *See, e.g.*, Complaint ¶ 100, *Sweda v. Univ. of Pa.*, 2017 WL 4179752 (E.D. Pa. Sept. 21, 2017) (No. 2:16-cv-04329), ECF No. 1 (alleging that plan fiduciaries breached their duty of prudence by offering a fund that trailed "two other . . . funds in the same investment style").

[3] Inv. Co. Inst., Frequently Asked Questions About 401(k) Plan Research, https://www.ici.org/policy/retirement/plan/401k/faqs_401k.

56, 64 (2d Cir. 2016). So "whether a fiduciary's actions are prudent cannot be measured in hindsight." *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 424 (4th Cir. 2007).

B. Process is the touchstone for evaluating asset management.

The measure of an asset manager's performance is not whether its investment selections resulted in above-average returns, compared to the competition (measured *ex post*), but whether it implemented appropriate processes *ex ante* to make reasoned decisions.

Because of the prohibition on judgment by hindsight, courts evaluating ERISA prudence claims do not consider performance—which is inherently a hindsight assessment—but rather focus on whether the manager engaged in a prudent process. As this Court held in *Bunch v. W.R. Grace & Co.*, fiduciary decision making must be "viewed from the perspective of the time of the challenged decision rather than from the vantage point of hindsight." 555 F.3d 1, 7 (1st Cir. 2009) (quoting *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917-18 (8th Cir. 1994)). So when an investment decision results from "thorough investigative and decisional process," "it is

difficult, indeed impossible, given the standard of review . . . to legally challenge the[] actions." *Id.* Other courts employ similar standards, recognizing that consideration of a fund's performance sheds no light on whether an investment vehicle was appropriately conceptualized and implemented, and thus must be excluded from the assessment of prudence. *See, e.g.*, *PBGC ex rel. St. Vincent Catholic Med. Centers Ret. Plan v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 730 (2d Cir. 2013); *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 434 (3d Cir. 1996) (requiring investment decisions to be reviewed "according to an objective standard, focusing on a fiduciary's *conduct* in arriving at an investment decision, not on its results, and asking whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment") (emphasis added).

The U.S. Department of Labor has placed the same emphasis on process, interpreting the duty of prudence to be satisfied if the fiduciary's process is diligent:

> With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, [ERISA's prudence] requirements . . . are satisfied if the fiduciary:

> (i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and
>
> (ii) Has acted accordingly.

29 C.F.R. § 2550.404a-1(b)(1).

II. TO ENGAGE IN A PRUDENT PROCESS, AN ASSET MANAGER NEED NOT FOLLOW THE HERD.

Without considering hindsight, there is little left to Plaintiffs' complaint. Here, as the district court found, Plaintiffs do not dispute that the Stable Value Fund satisfied the objectives disclosed to Plan participants. They do not "criticize any aspect of Galliard's investment process or of CVS's monitoring of Galliard's investment process." A.10.

Rather, Plaintiffs' theory is that Galliard's "failure" to pursue the strategy employed by certain other stable value funds demonstrates the plausibility of their claim for fiduciary breach because the Galliard fund's level of risk diverged from the average of other funds, and because other stable value funds purportedly

availed themselves of risk-free additional returns generated by investing the stable value fund in longer-duration bond funds.

Plaintiffs are wrong as to their general point (about the desirability of following the herd); and wrong as to the application in the stable value fund context.

A. Asset managers reasonably differentiate their investment offerings from competitors' funds.

On appeal, Plaintiffs contend that their challenge to the Stable Value Fund is justified because it "deviated from known and well-established industry standards." Pls.' Br. 21.

Such was the claim in *DeBruyne*, where the Seventh Circuit rejected the claim that losses sustained on Black Monday by Equitable's "Balanced Fund" resulted from imprudence because Equitable's fund did not reflect the same balance as other "balanced funds." The Seventh Circuit held that "assertions of what a 'typical' balanced fund portfolio manager might have done in 1987 say little about the wisdom of Equitable's investments, only that Equitable may not have followed the crowd." 920 F.2d at 465.

The *DeBruyne* approach is the right one. The contrary presumption—that deviations from typicality support an inference

of imprudence—would undermine the interests of plan fiduciaries in having choices along the risk/return spectrum..

Even if there were such a thing as a typical stable value fund,[4] it does not benefit investors to be restricted to investment options that cluster tightly around an "average"; to the contrary, it benefits investors to have investment lineups that reflect conscious decisions about the objectives of the population.

To return, again, to the fundamentals, 401(k) investors come in all shapes and sizes. Some are old, some are young. Some have considerable wealth, some are dependent on their plan balances to make ends meet. Different plans can be expected to have different populations of plan participants; one would not, for example, expect that CVS's employee population would resemble that of a Silicon Valley startup or a hedge fund. Different investor populations will sometimes indicate different strategies. Even within a single asset class, the circumstances of the targeted population may counsel in

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[4] *But see, e.g.*, Andrew Apostol, *How to Evaluate Stable Value Funds and Their Managers*, Dwight Asset Management Company (July 2007) ("Due to the varying expectations of individual plan sponsors and the range of management techniques used by their stable value managers, there is not a single style or strategy that is common across all stable value funds.").

favor of a more aggressive—or a more conservative—posture. Fiduciaries to a plan such as CVS's may wish to have a more conservative stable value fund than those chosen by plans with different populations.

It is particularly relevant here that this case involves how the CVS Plan's most conservative investment option was invested in the immediate aftermath of the 2008 financial crisis—which highlighted the risks of assets previously thought to be safe. Different investment populations reasonably greeted this "New World Order" with different strategies; and fund managers reasonably crafted funds with different risk profiles to meet the concerns of the marketplace.

As a broader matter, it is a basic tenet of modern investment management that diversification—and a diversity of investment options—expands the horizon of desirable portfolios. Were this Court to accept the theory that Plaintiffs could survive a motion to dismiss—and subject plan fiduciaries and fund managers to the significant costs of discovery—merely by identifying deviations from industry averages, then the whole financial marketplace would suffer from the reduced choice that would predictably result. If an

investment manager that diverges from the average in the level of risk that it assumes or in its general investment strategy has a litigation target on its back, those funds will not long be offered, at least not to retirement plans that are subject to ERISA.

B. Investing in longer-duration bonds does not provide an opportunity for stable value funds to achieve additional returns without additional risk.

As applied to the stable value context, Plaintiffs' assertion is that other stable value funds follow the "typical" model because it permits them access to greater returns without additional risk.

The district court deemed it implausible that investors could get something for nothing. The district court was correct.

Stable value funds have desirable features. By combining bonds and an investment wrap, participants can achieve bond-like returns without the interest-rate volatility present in bond funds. But those features do not *eliminate* the risk of losses, they just delay them. The stability-enhancing features of a stable value fund mean that, if a stable value fund invests in a bond that defaults, the value of the fund will not take an immediate tumble, but the loss will be amortized over a period of time. Over the long run, the performance of a stable value fund approaches the performance of

the underlying bond portfolio, minus the expenses of maintaining the wrap coverage and administering the fund.

This is, then, a long way of restating the obvious: There is no such thing as a free lunch. Bonds with a longer duration are likelier to be defaulted, which is why, except in anomalous interest-rate environments, longer bonds have higher yields. So a stable value fund with a longer duration is riskier than a fund with a shorter duration. Were this not so, stable value funds would be investing primarily in 10-, 15-, and 20-year bonds, rather than in 1-, 2-, and 3-year instruments.

III. ERISA DOES NOT PERMIT A CAUSE OF ACTION FOR CHAGRIN.

A final point bears mention. After eliminating the possibility of procedural improprieties by CVS or Galliard in the management of the Stable Value Fund and discounting the suggestion that Plaintiffs should somehow have gotten greater returns without taking on additional risk, Plaintiffs' complaint can still be read to suggest that Plaintiffs deserved a most-conservative investment option that was at a different point on the efficient frontier of risks and returns.

Even when there is an array of appropriate investment options that can be combined to generate reasonable investment portfolios, somebody must make the ultimate decision about the point on the risk-return horizon on which to reside.

There are circumstances in which a fiduciary gets to decide, on another's behalf, how assets ought to be invested. (A defined-benefit pension plan is the classic example. *See generally Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999).) But "participant choice is the centerpiece of what ERISA envisions for [401(k)] plans." *Tibble v. Edison Int'l*, 729 F.3d 1110, 1134-35 (9th Cir. 2013), *vacated and remanded on other grounds*, 135 S. Ct. 1823 (2015). In a 401(k) plan, plan participants get to control "the degree of risk to which [their individual accounts] are subject." 29 C.F.R. § 2550.404c-1(b)(3)(i)(A).

The upshot is that CVS Plan participants who wanted exposure to greater risk had options for exposing themselves to greater risk. Unless they can show that the Stable Value Fund was managed through an imprudent process, Plaintiffs cannot escape the risk-return combination that they elected. ERISA is not an insurance policy that allows individuals who opted to forgo risk to

claim the benefits of higher returns after the market has proven strong. *See Sweda*, 2017 WL 4179752, at *10 ("Chagrin does not inexorably become a cause of action.").

CONCLUSION

The judgment of the district court should be affirmed.

Dated: October 10, 2017

s/ Brian D. Netter

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations of Fed. R. App. P. 29(a)(5) and Fed. R. App. P. 32(a)(7)(B)(i) because it contains 3,077 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2007 in Bookman Old Style 14-point font.

s/ Brian D. Netter

CERTIFICATE OF SERVICE

I hereby certify that on October 10, 2017, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the First Circuit by using the CM/ECF system, which will electronically serve all registered counsel of record.

s/ Brian D. Netter