

Employee Benefit ■ Plan Review

ERISA Requires a Fiduciary to Employ a Prudent Process in the Selection of Investment Options, Not Investment Success

BY LORI A. MARTIN, BRAD E. KONSTANDT AND CHARLES C. BRIDGE

“Sometimes, even a good process produces disappointing results.” With that introduction, the U.S. Court of Appeals for the

Third Circuit unanimously affirmed the district court’s grant of summary judgment to Quest Diagnostics, a plan sponsor, in a comprehensive opinion highlighting the centrality of process to courts’ consideration of ERISA breach of fiduciary duty claims.¹ The decision is significant because it is one of the first circuit court decisions considering summary judgment in the recent spate of class actions directed to the performance of target-date funds in retirement plans. It roundly rejects an attempt to impose liability solely because a fund produced “subpar returns.” The opinion underscores that plan fiduciaries do not “need crystal balls”; rather, a sound, well-documented process should defeat ERISA claims even where fund performance—especially short-term performance—may have lagged.

Plan fiduciaries should be heartened by this decision, a full-throated defense of process over prescience. Plan fiduciaries also should take guidance from the Third Circuit’s reliance on a clear factual record that established a prudent process through the fiduciary committee’s retention of an adviser and critical evaluation of plan investments. For the defense of ERISA

imprudence claims, there is no substitute for documentation of the fiduciary’s deliberative process.

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BACKGROUND

Plaintiffs alleged that Quest and the plan committees overseeing its defined contribution retirement plan (the Plan) breached fiduciary duties owed to Plan participants under ERISA. Specifically, plaintiffs challenged the continued offering of two investment options in the Plan: the Fidelity Freedom Funds (a suite of actively managed target-date funds) and the Invesco Global Real Estate Fund (an actively managed mutual fund that primarily holds real estate investment trusts). Plaintiffs alleged that the actively managed Freedom Funds performed worse than passively

managed alternatives and that the Invesco Fund also underperformed comparable funds. Plaintiffs further claimed that the investment committee's policy statement required the committee to remove both options from the Plan menu.

Plaintiffs' complaint asserted three causes of action. Count One alleged that, by continuing to offer the allegedly underperforming funds, the sponsor violated its fiduciary duty under 29 U.S.C. § 1104(a) (ERISA § 404(a)). Count Two alleged that the same action violated the fiduciaries' duty to monitor the Plan adequately under 29 U.S.C. §§ 1105(a) and 1109(a) (ERISA §§ 405(a) and 409(a)). Alternatively, Count Three claimed that even if the sponsor and its committees were not fiduciaries, they were liable for knowing breach of trust.

The district court granted defendants' motion for summary judgment. The court found no breach of fiduciary duty because the sponsor had hired an investment adviser, actively monitored the Plan's investment menu and took reasonable action to monitor the challenged funds. Because there was no breach of fiduciary duty, the failure-to-monitor and knowing-breach-of-trust counts were not tenable.

QUEST DID NOT BREACH ITS ERISA DUTIES NOTWITHSTANDING "SUBPAR" INVESTMENT RESULTS

The Third Circuit affirmed, agreeing with the district court that the sponsor fulfilled its fiduciary duties under ERISA. The threshold question for imprudent investment claims is whether the fiduciary engaged in a prudent process for the oversight of those investments. The sponsor did so.

The court methodically reviewed the diligence undertaken by the sponsor, highlighting well-recognized forms of prudence. Notably, the investment committee met quarterly and hired two investment advisers

to inform the committee. The committee actively reviewed the information provided by the consultants and "did its own homework"; it did not "mindlessly follow" consultant recommendations nor "simply defer to" its advisers.

As guidance for future litigation, the Third Circuit identified three considerations for evaluating fiduciary performance: "(1) Did the fiduciaries review their advisors' data and seek more if needed? (2) Did they analyze and understand the bases for the opinions on which they relied? And (3) did they otherwise use a process that was reasonable under the circumstances?" The court held that the sponsor did all three.

- As to the first question, the court determined that the sponsor "reflected critically" on the consultant's findings, which noted concerns about the target-date funds' performance against alternative funds but did not advocate replacing them. The committee did further diligence on the target-date funds' performance and underlying strategy, including meeting with the funds' investment adviser to discuss the funds and weighing the merits of active versus passive funds and funds with different glide paths. The committee also instructed its consultant to reanalyze target-date fund options a few years later.² The same was true for the challenged real estate fund: The committee analyzed the fund's performance, put the fund on an internal watch list, met with representatives from the fund's investment adviser and considered alternative funds.
- As to the second question, the court found that the sponsor understood the consultants' review methodology and the information and data underlying their opinions. The sponsor "could articulate why the opinions that it relied on made sense." Additionally, the sponsor

understood the target-date funds' "benefits and risks" and why the consultant recommended keeping the funds notwithstanding a period of underperformance. Similarly, the sponsor understood the investment approach utilized by the challenged real estate fund and why it caused periods of underperformance. There was "no real evidence that [the sponsor] was ignorant of [the consultant's] methodology" underlying its recommendation that the Plan continue to offer the real estate fund on the Plan menu.

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- Finally, as to the third question, the court found that the sponsor followed generally accepted practices of plan management. "In addition to hiring and meeting regularly with an investment adviser, the [c]ommittee repeatedly revised the Plan's menu," replacing funds and putting funds on watch lists over time.

SHORT-TERM UNDERPERFORMANCE DOES NOT PROVE A FIDUCIARY VIOLATION

The court held that short-term underperformance could not sustain the imprudent investment claim. The court stated that plaintiffs "cannot just point to another investment that has performed better in a five-year snapshot of the lifespan of a fund that is supposed to grow for fifty years to prove that fund was an unreasonable investment" (internal quotations omitted). There may

be sound reasons to hold on to an investment option during a period of weaker returns. For the target-date funds selected for the Plan, for example, the committee favored the glide path methodology and equity allocations over alternative options in the market. And even if an investment's underperformance could show that a fiduciary's process was imprudent, that underperformance "would have to be severe and sustained enough to warrant that conclusion."

The record did not suggest egregious, long-term underperformance. As a threshold matter, the court rejected plaintiffs' claim that the actively managed target-date funds lagged passively managed funds. The comparison was inapt because active and passive index funds are "apples and oranges. They are not materially identical investments and are not fungible." Moreover, the court observed that it was "not obvious" that the funds were bad investments, even if other funds in the same asset class performed better for a period of time. "[M]inor underperformance . . . does not demand immediate change, especially when the goal is long-term growth." Indeed, "[r]equiring fiduciaries to cut every below-average fund would create chaos."

QUEST PROPERLY CONSIDERED THE INVESTMENT POLICY STATEMENTS' NON-BINDING FACTORS

Plaintiffs asserted that certain provisions of ERISA rendered the Plan's investment policy statements binding on the sponsor, and that the investment committee's failure to follow them resulted in a breach of fiduciary duty.³ The policy statements, however, "gave the [c]ommittee discretion to deviate from them, so [the sponsor] never violated them." In fact, the policy statements "were full of permissive language" and "underscored that '[n]o single factor' is dispositive" in evaluating an investment. Principles of trust law favor

deferring to trustees' judgment calls, and the committee did not abuse its discretion in choosing to keep the challenged funds following careful consideration of the fund strategies, performance (and underperformance) and alternatives in the market, consistent with the policy statements.

The Third Circuit's decision has important implications for ERISA litigation involving imprudent investment claims.

IMPLICATIONS FOR FUTURE ERISA LITIGATION

The Third Circuit's decision has important implications for ERISA litigation involving imprudent investment claims:

- The decision emphatically states that process—not outcomes—is key. A diligent investment review process should insulate fiduciaries from liability even when a fund performs poorly, at least in the short term. As the Third Circuit succinctly stated: "ERISA mandates prudence, not perfection."
- Where plan fiduciaries hire outside investment advisers, they should critically examine the adviser's recommendations and data and follow up as needed, especially where an investment has underperformed. Plan fiduciaries should actively engage with their advisers and ensure that they fully understand the why behind a recommendation.
- Documenting the fiduciary process is critical. The key to proving procedural prudence is a well-documented record. A sound process can be

undermined in litigation if a defendant must rely on incomplete records and testimony. ERISA claims may not reach summary judgment or trial until a decade after the challenged events, when witness memories may fade and institutional knowledge may erode.

- The decision emphasizes that investment comparisons must be apples to apples. Actively managed funds may not be comparable to passively managed funds because "they reflect two different investment strategies."
- Short-term underperformance may not be the proper measure of prudence. Plan fiduciaries are not obligated to remove funds that underperform for limited periods. There may be sound reasons to continue to make a fund available to plan participants, even during a period of weaker returns. Plan fiduciaries should examine the reasons for short-term underperformance and document those efforts, including the reasons why they conclude that a fund should not be replaced.

The Third Circuit's opinion helps inform district courts of the forms of monitoring and review of investment performance that demonstrate plan fiduciaries satisfied their duty of prudence.

- This was only the second summary judgment decision by a circuit court considering imprudent investment claims concerning target-date fund suites.⁴

The Third Circuit's opinion provides meaningful support for dismissal where fund performance challenges are based on inapt comparisons and/or where plan fiduciaries can establish a factual record that demonstrates a robust monitoring process for the challenged investments, including the decision-making rationales (based on long-term performance, glide paths, allocation differentiations, etc., across fund suites).

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IN SUMMARY

- The Third Circuit affirmed the importance of the fiduciary's prudent process in assessing liability for an ERISA breach of fiduciary duty claim regarding the selection of investment options.
- ERISA does not impose liability solely because a selected investment option produces "subpar returns."
- For the defense of ERISA imprudence claims, there is no substitute for a clear record documenting the fiduciary's deliberative process. 🌀

NOTES

1. In re Quest Diagnostics ERISA Litig., 179 F.4th 217 (3d Cir. 2026).
2. The court rejected the import of an "isolated email" from a fund investment adviser complaining that "the committee does not typically review my materials." While acknowledging that this was a "bad fact" for the sponsor, the court found that it was just "a scintilla of evidence," not enough to create a genuine issue of material fact about prudence.
3. Plaintiffs cited 29 U.S.C. § 1104(a)(1)(D), which provides that ERISA fiduciaries must "discharge [their] duties . . . in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with" ERISA. The court described this argument as "novel" in the Third Circuit.
4. See Pizarro v. Home Depot, Inc., 111 F.4th 1165 (11th Cir. 2024).

The authors, attorneys with Wilmer Cutler Pickering Hale and Dorr LLP, may be contacted at lori.martin@wilmerhale.com, brad.konstandt@wilmerhale.com and charles.bridge@wilmerhale.com, respectively.

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