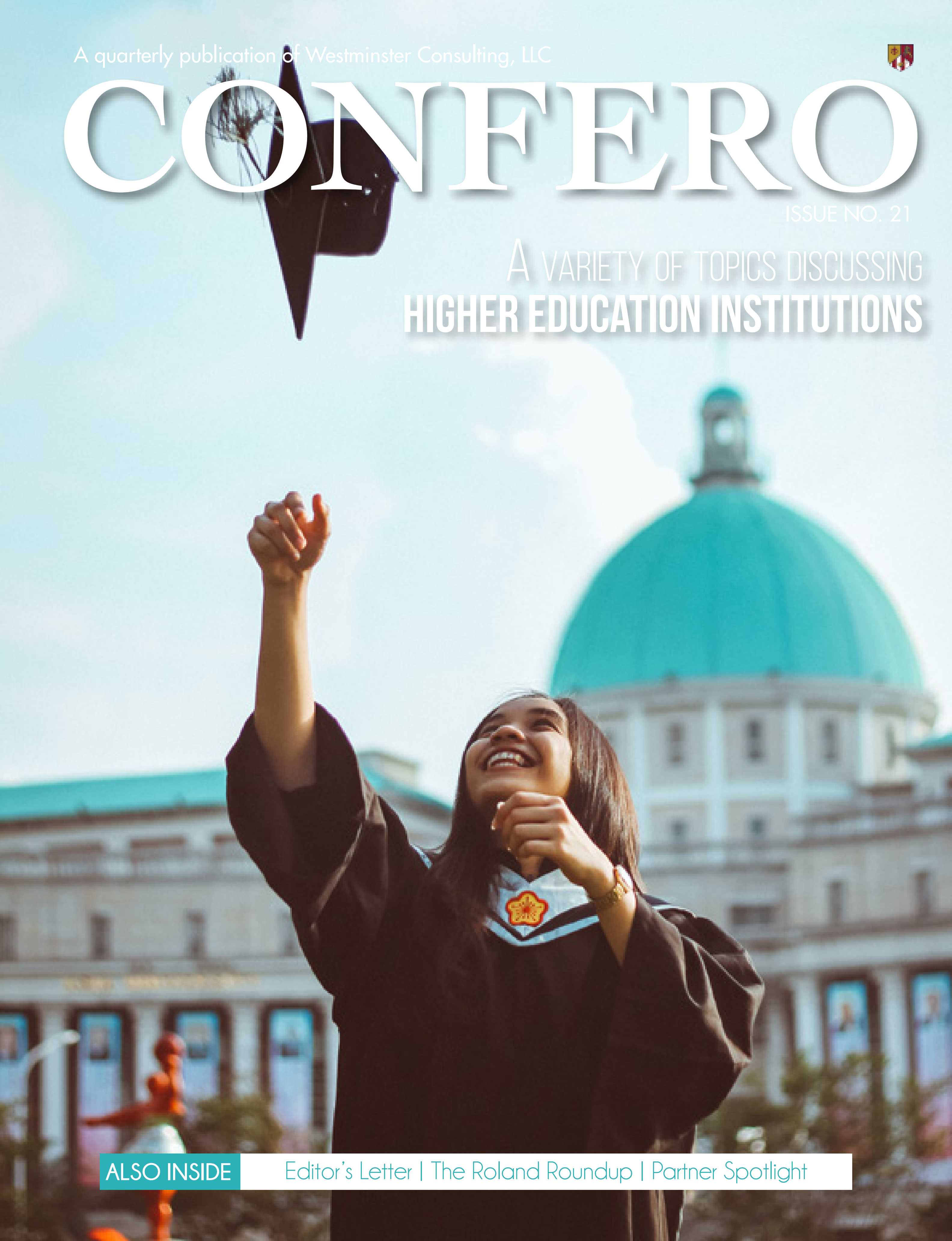
A quarterly publication of Westminster Consulting, LLC

CONFERO

ISSUE NO. 21

A VARIETY OF TOPICS DISCUSSING HIGHER EDUCATION INSTITUTIONS



ALSO INSIDE Editor's Letter | The Roland Roundup | Partner Spotlight

MAJOR UNIVERSITIES AND MONITORING

Major Universities Become Focus of Breach of Fiduciary Duty Claims Arising out of Failure to Monitor Their 403(b) Plans

By Kathy Aslinger and Jenna Macnair

While 403(b) and 401(k) retirement plans have different historical roots that once demanded different fiduciary duties from administrators, those differences have largely eroded over time. Today, fiduciary requirements of 403(b) plan administrators are nearly identical to those of 401(k) administrators.[1] In fact, the fiduciary duty standard set forth in the Employee Retirement Income Security Act ("ERISA") does not differentiate between 403(b) and 401(k) plans, but rather defines a blanket fiduciary duty standard aiming "to provide a uniform regulatory regime over employee benefits plans." Accordingly, the courts are increasingly treating breach of fiduciary duty claims against 403(b) and 401(k) plan administrators in kind.

Since August 2016, district courts across the country have been grappling with a wave of cases filed against private universities that sponsor 403(b) plans subject to ERISA.[2] The lawsuits are extremely similar to the retirement plan fee lawsuits that have been filed against large corporate 401(k) plan sponsors, many of which were settled for very large amounts. These actions allege in part that the university 403(b) plans, most with significant assets, have not been managed prudently or for the exclusive purpose of providing benefits to participants and their beneficiaries, in violation of ERISA.[3] Each complaint contains similar allegations that attack common 403(b) plan investment practices and plan design features. While none of the suits have reached the merits stage, the district courts' pre-trial decisions to dismiss certain claims while allowing others to move forward offer insight into the expectations for modern 403(b) fiduciaries and how 403(b) plan sponsors can best to meet their fiduciary obligations going forward. The primary themes of these lawsuits are explored below.

Excessive Recordkeeping Fees

All retirement plans must pay for recordkeeping and other services, and those costs are either paid by the employer or passed through to the participants. Many of the plans at issue in the universities' suits utilize asset-based revenue-sharing payments to pay recordkeeping expenses. In revenue-sharing arrangements, fees are charged to the accounts of participants as investment expenses based on the value of their account balances, and then a portion of those fees are paid to recordkeepers, investment advisors, brokers, and other service providers. Plaintiffs allege that this practice has resulted in excessive fees and overcompensation of the plans' recordkeepers, and argue that the plan sponsors should have leveraged their significant size to negotiate a flat dollar, per participant fee to manage the overall cost. Further, plaintiffs allege that the plan fiduciaries failed to seek competitive bids from other recordkeeping services or otherwise attempt to monitor or control the recordkeeping fees.

Many of these excessive recordkeeping fee claims survived defendants' motions to dismiss, indicating that courts are willing to entertain claims that plan fiduciaries failed to monitor the appropriateness of their fee structures, particularly in instances where plaintiffs were able to point to the availability of alternative, more competitive recordkeeping services.[4]

Multiple Recordkeepers

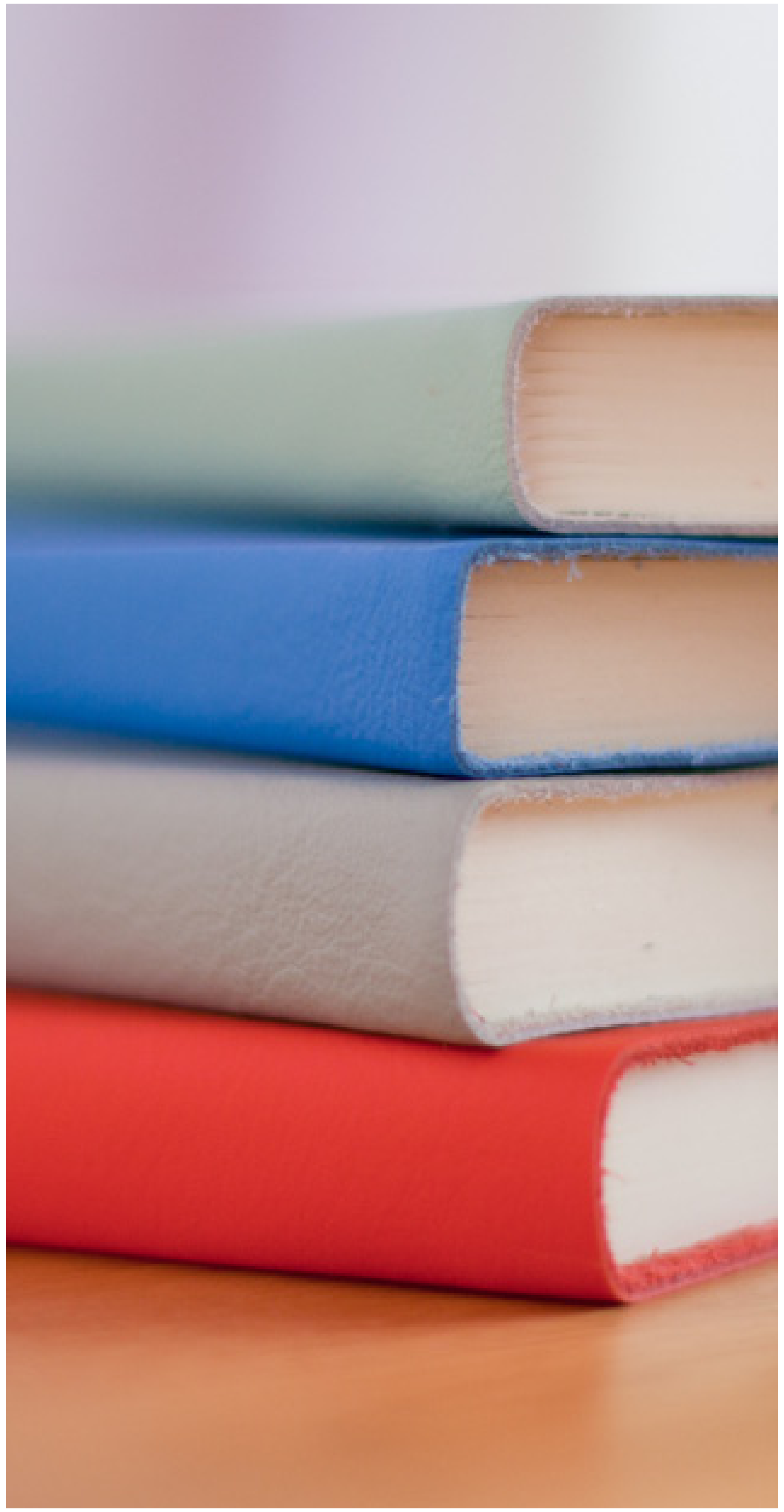
403(b) plans developed out of annuity products that were designed to be portable. When a plan participant moved to another job, he could take his existing annuity products and associated service providers with him, in addition to the service providers offered by his new employer's 403(b) plan. This historical background explains why many of today's 403(b) plans, including those at issue in the universities' litigation, have multiple recordkeepers. The plaintiffs allege, however, that this practice is inefficient, costly, and undermines the plans' abilities to negotiate more favorable terms. The plaintiffs assert that the plan fiduciaries should have instead consolidated their recordkeeping structure to employ only one recordkeeper.

The courts' responses to these claims have been mixed. Some courts were unconvinced that the existence of multiple recordkeepers is enough on its own to sustain a claim of imprudence, particularly given the likelihood of other rational reasons for the behavior (e.g., "bundling" investment options and recordkeepers is consistent with free market behavior, and retaining a second recordkeeper may result in the availability of certain funds that are not available through the first recordkeeper).[5] Other courts were swayed by plaintiffs' evidence of specific, similarly-sized plans that retained a single recordkeeper and enjoyed lower costs.[6]

Selection and Retention of High-Priced and Underperforming Funds

The plaintiffs allege that plan fiduciaries failed to adequately evaluate the funds and remove high-fee and poorly-performing options. First, plaintiffs target the inclusion of annuity products as plan investment options. Historically, 403(b) plans originated out of and were limited to annuity products. Thus, they were unsurprisingly a common feature in the universities' 403(b) plans. In fact, a 2013 study reported that 23% of all ERISA 403(b) plan assets were held in fixed annuities and another 28% were held in variable annuities.[7] Annuity products typically charge significant fees and have strict distribution rules that limit participants' ability to withdraw from the annuity products after a short period of time. Due to their high fees and distribution restrictions, plaintiffs allege that including annuity products as plan options was imprudent. Additionally, plaintiffs complain about use of specific actively managed mutual funds, which had historically underperformed relative to their benchmark and had significantly higher fees compared to passively managed alternatives. Plaintiffs offered detailed histories of the funds' performance, with some dating back ten years.

Several courts sustained claims that maintaining specific high-fee and under-performing funds, including certain annuity products and actively managed funds, may have been imprudent. Courts were particularly willing to consider imprudence claims where plaintiffs were able to show a fund history of failing to meet applicable benchmarks and the existence of better performing, lower cost funds.[8]



[1]Nat'l Sec. Sys., Inc. v. Iola, 700 F.3d 65, 82 (3d Cir. 2012) (quoting Aetna Health Inc. v. Davila, 542 U.S. 200, 208 (2004)).
[2]Suits have been filed against Brown, Columbia, Cornell, Duke, Emory, John Hopkins, University of Pennsylvania, Princeton, MIT, Northwestern, NYU, University of Southern California, Vanderbilt, Washington University, and Yale.
[3]See 29 U.S.C. § 1104(a)(1).
[4]E.g., Sacerdote v. New York Univ., 2017 WL 3701482, at *8-10 (S.D.N.Y. Aug. 25, 2017), reconsideration denied, 2017 WL 4736740 (S.D.N.Y. Oct. 19, 2017).
[5]E.g., Sweda v. Univ. of Pennsylvania, 2017 WL 4179752, at *9 (E.D. Pa. Sept. 21, 2017).
[6]E.g., Sacerdote v. New York Univ., 2017 WL 3701482, at *9 (S.D.N.Y. Aug. 25, 2017), reconsideration denied, 2017 WL 4736740 (S.D.N.Y. Oct. 19, 2017).
[7]See "The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at ERISA 403(b) Plans, 2013" (May 2016), at https://www.ici.org/pdf/ppr_16_dcplan_profile_403b.pdf, 34 (last visited 12/6/17).

Maintaining Retail Class Investment Products

Plaintiffs also targeted their plans' inclusion of retail class mutual funds. Retail class mutual funds generally differ from institutional class funds in that they include higher fees, and plaintiffs allege that failing to replace the retail funds with lower-cost mutual funds was imprudent.[9] However, many courts were unwilling to entertain these claims. First, the courts indicated that where retail class funds were just a small portion of the available plan options, their availability was not imprudent. Second, the courts acknowledged the non-fee-related benefits of retail class funds – namely, that they enjoy higher liquidity than institutional class funds.[10] Thus, without further allegations of imprudence, the courts held that the high fees associated with retail class funds were not indicative of a breach of fiduciary duty.

Too Many Investment Options

Finally, several of the plans included over 100 total investment options, many of which were duplicative. 403(b) plans have historically offered a large number of investment options since they often incorporated multiple vendors, each offering their full menu of mutual funds or annuity products. A recent study from 2013 found that plans with more than $1 billion in plan assets offered an average of 136 investment options.[11] Similarly, many of the university plans targeted by these lawsuits held over $1 billion in assets and included over one hundred investment options. Plaintiffs claim that such a "dizzying array" of options led to "decision paralysis" for plan participants. Nonetheless, the majority of courts were unconvinced by the plaintiffs' argument given that they did not allege any actual harm suffered.[12] In addition, many of the plans included several tiers of investment options, ranging from "do-it-for-me" to entirely self-directed. If anything, the courts held that the tier systems served to guide participants and mitigate confusion.[13]

"Plan sponsors should take steps to ensure that they are meeting their fiduciary obligations under ERISA."

Conclusions

While the overall impact of this series of litigation remains unknown, universities, like all other plan sponsors, should take steps to ensure that they are meeting their fiduciary obligations under ERISA by adopting and maintaining procedures for the review and continued monitoring of their administrative fees, recordkeeping relationships and structure, plan makeup and design, and performance of investment options. Throughout this process, plan sponsors should be mindful that their decisions should first and foremost promote the best interests of plan participants and beneficiaries.

[8] E.g., Henderson v. Emory Univ., 252 F. Supp. 3d 1344, 1351-1352 (N.D. Ga. 2017).
[9] E.g., Sacerdote v. New York Univ., 2017 WL 3701482, at *11 (S.D.N.Y. Aug. 25, 2017), reconsideration denied, 2017 WL 4736740 (S.D.N.Y. Oct. 19, 2017).
[10] E.g., Sweda v. Univ. of Pennsylvania, 2017 WL 4179752, at *9 (E.D. Pa. Sept. 21, 2017).
[11] See "The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at ERISA 403(b) Plans, 2013" (May 2016), at https://www.ici.org/pdf/ppr_16_dcplan_profile_403b.pdf, 27-8 (last visited 12/6/17).
[12] E.g., Sweda v. Univ. of Pennsylvania, 2017 WL 4179752, at *9-10 (E.D. Pa. Sept. 21, 2017).
[13] Id.