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403(b) Plans Under Attack: Fiduciary Breach Class Actions Brought Against Multiple University Plans

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History of 403(b) Plans

Application of ERISA to 403(b) Plans

- 1975 DOL "limited-involvement" regulations
  - Employee participation is voluntary
  - No employer contributions are made to the plan
  - Rights are enforceable solely by the employee
  - Plan sponsor's involvement limited to:
    - Holding 403(b) contracts
    - Permitting vendors to publicize the plan
    - Remitting salary reductions
    - Summarizing information about the plan
  - Plan Sponsor can reasonably limit number of vendors, but cannot receive compensation from vendors

Final 403(b) Regulations

- Issued on July 23, 2007 (effective January 1, 2009)
- Overall impressions of the final regulations
  - IRS referred to a “change in culture” recognizing the 403(b) as an employer plan rather than a payroll accommodation
  - Incorporated many 401(k) requirements and interpretations
  - Written plan document requirement
  - Restrictions on employee changes in investments
  - Increased employer obligations with respect to the product providers
  - Grandfathered certain investments
  - Enumerated consequences of defects or errors

Clarifications to the DOL Safe Harbor

- FAB 2009-02
  - Do not need to treat annuity contracts and custodial accounts as plan assets if:
    - the contract or account was issued to a current or former employee before January 1, 2009
    - the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and ceased making contributions to the contract or account before January 1, 2009
    - all of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer
    - the individual owner of the contract is fully vested in the contract or account

Clarifications on the DOL Safe Harbor (continued)

- FAB 2010-01
  - Must offer reasonable choice of both vendors and investment products
    - Facts-and-circumstance analysis takes into account whether the choice of providers and investment products is reasonable
  - Cannot have discretionary authority over participants' investment transfers from one vendor to another
  - Loans, hardships and other optional features permitted, but any discretionary determinations must be made by the vendor
  - Vendors that do not comply with the 403(b) regulations can be terminated

ERISA Fiduciary Duties

Who is a “fiduciary” under ERISA?

- Generally, four ways to be a fiduciary
  - Named in plan document
  - Authority to manage/dispose of plan assets & plan investments
  - Discretion over plan administration
  - Investment advice for a fee

Investment Duties of Fiduciaries Under ERISA

- Duty of prudence
  - Procedural prudence requires plan fiduciary to perform due diligence and gather all relevant information
  - Substantive prudence requires plan fiduciary to have necessary expertise or consult investment experts
- "Appropriate consideration" must be given
  - Role of proposed investment in portfolio
  - Risk of loss and opportunity for gain, and portfolio diversification
  - Liquidity and cash flow needs
- Instead of looking at a proposed investment in isolation, look at its relationship to the overall portfolio

Investment Duties of Fiduciaries Under ERISA (continued)

- *Tibble v. Edison Int'l*, 135 S. Ct. 1823 (2015)
  - Ongoing duty to monitor investments
    - ERISA's fiduciary duties are derived from the common law of trusts
    - Under common law of trusts, managing embraces monitoring of investments, and a fiduciary should systematically consider the investments at regular intervals
  - Excessive fees
    - Inclusion of retail class mutual funds with high fees held imprudent
    - Fiduciaries failed to investigate institutional class alternatives

Fee-Related Duties Under ERISA

- Excessive fee litigation
  - Investment fees must be reasonable in light of qualifications of provider and quality of investment services
  - No duty to choose cheapest investments
- Revenue sharing payments
  - Duty to investigate and disclose “revenue sharing” payments received by providers
  - Cannot select mutual funds for revenue sharing
  - Successful challenges to revenue sharing arrangements have focused on alleged self-dealing by 401(k) plan sponsors (i.e., payments were used to subsidize other corporate, non-plan related services provided by the recordkeeper)

Other Related Duties Under ERISA

- Participant Disclosures
  - Must provide sufficient information on plan investment options
  - Detailed requirements under DOL's 404a-5 Regulations
  - Additional requirements for QDIA (Qualified Default Investment Alternative for plans with auto enrollment)

Breach of Fiduciary Duties

- Statute of Limitations
  - Six years after "the date of the last action [by the fiduciary] which constituted a part of the breach" or, if earlier, within three years after the earliest date on which the plaintiff had actual knowledge of the breach
- Liability imposed by ERISA § 409
  - "Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach"
- Statutory remedies are contained in ERISA § 502
  - Allows for claims seeking denied benefits, equitable relief, and recovery of losses stemming from fiduciary breaches

Recent 403(b) Plan Litigation: The University Lawsuits

Overview

- Class action lawsuits filed against 12 universities in August of 2016
  - Columbia, Cornell, Duke, Emory, Johns Hopkins, MIT, NYU, Northwestern, Penn, USC (University of Southern California), Vanderbilt, and Yale
  - Same law firm that initiated 2006 401(k) fee litigation
    - Except that another firm also initiated a claim against Columbia
  - Defendants include sponsoring employers, plans' investment and administrative committees, and employees (e.g., VP of HR)
  - Complaints seek certification of a class of all similarly situated participants in their respective plans
  - Plan providers *not* joined as defendants

Core Allegations

The Plans Had…	The Plans Should Have Had…
Multiple recordkeepers (some of whom charged for duplicative work)	One recordkeeper to keep fees lower
Revenue-sharing arrangement that resulted in excessive fees	Either no revenue sharing or better controlled so service provider paid only a reasonable amount
Fees based on assets, resulting in excess fees per participant	Flat fees per participant
No open, competitive bidding process for recordkeepers	Competitive bidding every 3 years or so
Service provider selected because of relationship with fiduciary	Independent provider selected solely in best interest of participants
Too many core/window investment options that confused participants	Smaller number of options with varied risk/return

Core Allegations (continued)

The Plans Had…	The Plans Should Have Had…
Actively managed funds with higher expenses that had no actual performance benefit	Passively managed funds with lower expenses that performed just as well
Investment options with severe restrictions on liquidity and penalties for early withdrawal	Investment options that allowed participants to move and withdrawal funds without penalty or restriction
Duplicative investment options with different expense ratios (retail v. institutional classes)	One option for a target index with the lowest expense ratio
Particular investment management company funds that were more expensive than competitor fund	The cheapest available with comparable performance
Historically underperforming funds	New funds introduced when funds underperformed

Requests for Relief

- In addition to restoration of all losses, plaintiffs seek:
  - Declaration that defendants breached their fiduciary duties
  - Accounting of all transactions and dispositions in connection with plans and their assets
  - Surcharges
  - Reformation of the plans to include only prudent investments
  - Require the plans to obtain bids for recordkeeping and “to pay only reasonable recordkeeping expenses”
  - Attorneys’ fees and costs
  - Other equitable or remedial relief

Universities' Arguments in Motions to Dismiss

- Common themes in the motions to dismiss
  - Participants do not allege a flawed investment decision-making process and, instead, focus solely on investment fees and performance
  - Multi-recordkeeper platform is the norm in the 403(b) market, as evidenced by the similar facts in all 12 lawsuits
  - Minimizing fees is just one of the factors considered in deciding whether to consolidate recordkeepers
    - Alleged duplicative investment options had different objectives and performance returns
  - ERISA does not require periodic competitive bidding
  - No court or agency requires only a flat per participant fee

Universities' Arguments in Motions to Dismiss (continued)

- The many investment options offered by the plans satisfy ERISA's investment option requirements
  - A fund's poor performance itself is not a sufficient basis to create an inference that fiduciaries failed to conduct an adequate investigation
- Some of the motions also argue that plaintiffs lack constitutional standing because the complaints fail to plead injury in fact and entitlement by the particular plaintiffs to adjudication of the particular claims asserted, and that the injury alleged was not concrete and particularized

Some Questions the Cases May Answer

- Wide array of investment choices
  - The defendants can reasonably argue that university employees preferred the kind of individual control that had been fundamental to their plans for decades. From that perspective, the plan fiduciaries could be seen to have acted prudently, simply giving the participants what they wanted.
  - These cases will address whether fiduciary standards that have been promoted in the 401(k) plan litigation can necessarily be applied to 403(b) plans
- Types of investment options
  - The fiduciaries' obligations in these cases will have to be considered in a context in which annuities have long been a fundamental element (for decades, the *only* investment options allowed under 403(b) plans)
  - Legacy annuity contracts are often between the provider and the participant, not the plan sponsor, and in many cases by their terms cannot be removed as plan investment options as quickly as the complaints suggest

Some Questions the Cases May Answer (continued)

- Retention of more than one record keeper
  - The cases will also consider whether a 403(b) plan fiduciaries' retention of more than one record keeper complies with ERISA fiduciary standards
  - Defendants could respond to the argument made by the plaintiffs that more record keepers means higher fees, by arguing that engaging multiple record keepers creates more efficient and better services, given the variety of investment vehicles in 403(b) plans
- How these questions are answered will likely determine whether the initial cases are followed by an avalanche of more lawsuits or fizzle out due to failure
- Court decisions will likely influence decisions made by non-profit employers and plan fiduciaries in the coming years

Take Away Points

- Litigation related to excessive plan fees and fiduciary duties is rapidly growing and expanding into new areas
- The plaintiff's bar has succeeded in obtaining substantial settlements in similar lawsuits against 401(k) plans
- Plan sponsors should consider best fiduciary practices
  - Aggressively negotiating and monitoring service provider fees, comparing investment management fees against benchmarks, continuous monitoring of service providers and investments, and reviewing plan governance procedures to minimize

Take Away Points

- Plan sponsors should be thoughtful when communicating plan changes to participants
  - Several of the plan sponsors had recently winnowed both their recordkeepers and fund menus prior to the lawsuits
    - USC removed one of its recordkeepers (Prudential), eliminated hundreds of mutual funds (340 to 34 funds), removed certain fixed and variable annuity investment options, and froze contributions to certain other fixed and variable annuity investment options
  - Complaints noted that as part of the communications to participants, defendants "expressly acknowledged that the Plans' multiple recordkeeper structure and hundreds of investment options caused the Plans to pay unreasonable recordkeeping and investment fees."

Case Citations

- *Vellali et al v. Yale University et al,* No. 3:16-cv-01345-AWT (D. Conn.)
- *Sacerdote et al v. New York University*, No. 1:16-cv-06284-KBF (S.D.N.Y.)
- *Tracey et al v. Massachusetts Institute of Technology et al*, No. 1:16-cv-11620-NMG (D. Mass.)
- *Sweda et al v. The University of Pennsylvania et al*, No. 2:16-cv-04329-GEKP (E.D. Pa.)
- *Cassell et al v. Vanderbilt University et al*, No. 3:16-cv-02086 (M.D. Tenn.)

Case Citations (continued)

- *Clark et al v. Duke University et al,* No. 1:16-cv-01044-CCE-LPA (M.D.N.C.)
- *Henderson et al v. Emory University et al,* No. 1:16-cv-02920-CAP (N.D. Ga.)
- *Kelly et al v. The Johns Hopkins University,* No. 1:16-cv-02835-GLR (D. Md.)
- *Munro et al v. University of Southern California et al*, No. 2:16-cv-06191-VAP-E (C.D. Cal.)
- *Cates et al v. The Trustees of Columbia University in the City of New York et al*, No. 1:16-cv-06524-AT-RLE (S.D.N.Y.)

Case Citations (continued)

- *Doe v. Columbia Univ., S.D.N.Y., No. 1:16-cv-06488*
- *Cunningham v. Cornell University et al*, No. 1:16-cv-06525-PKC (S.D.N.Y.)
- *Divane et al v. Northwestern University et al*, N.D. Il., No. 1:16-cv-08157 (N.D. Ill.)

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