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Nonprofit Newsletter Fall 2016 - 403(b) Plan Sponsors, Beware of Excessive Fee Litigation

In recent months, a spate of class actions have been brought against more than a dozen major universities that sponsor 403(b) plans, including Columbia University, Cornell University, Duke University, Emory University, Johns Hopkins University, M.I.T., Northwestern University, N.Y.U., University of Pennsylvania, University of Southern California, Vanderbilt University and Yale University. The suits are filed against each university in its capacity as a fiduciary of a 403(b) retirement plan and allege fiduciary breaches under the Employee Retirement Income Security Act of 1974 (ERISA) relating to payments of excessive administration fees and failure to replace certain investment funds. These lawsuits signal that the wave of fee litigation cases that engulfed the 401(k) market will now extend to 403(b) plans subject to ERISA. These initial cases mark the beginning of a new generation of fee litigation cases.

403(b) plans are offered by public schools and nonprofit institutions, like universities and hospitals. Similar to 401(k) plans, 403(b) plans allow participants to invest their retirement savings, but typically use annuity contracts or custodial accounts invested in mutual funds as the investment vehicles. Traditionally, 403(b) plans offer a multitude of investment options and many plan sponsors structure their 403(b) arrangements with multiple vendors. Most, but not all, 403(b) plans are subject to ERISA. Government plans, certain church plans, and certain 403(b) plans that are limited to elective deferrals and that have limited employer involvement may be exempt from ERISA coverage. 403(b) plans subject to ERISA must comply with, among other requirements, ERISA's reporting and disclosure obligations and fiduciary rules. Specifically, the fiduciary of an ERISA-covered 403(b) plan is obligated to act for the exclusive benefit of participants and beneficiaries, to ensure that plan expenses are reasonable, and to ensure that plan investments are prudent.

The complaints generally allege that the universities, as sponsors of ERISA-covered 403(b) plans, breached their fiduciary duties under ERISA by:

- offering plan participants too many investment choices (hundreds, in many cases), many of which were duplicative and overly expensive and resulted in higher expense ratios and investment costs;
- offering higher-cost retail-share-class mutual funds instead of identical but lower-priced institutional-share-class funds;
- failing to replace more expensive, poor-performing investments with cheaper ones;
- retaining multiple record keepers, which resulted in excessive and duplicative fees, instead of consolidating providers and using the plan's size as bargaining power to demand lower fees;
- failing to conduct a thorough search for a plan provider, which could have uncovered a better and less expensive provider; and
- failing generally to leverage the plan's significant asset size to demand low-cost record-keeping, administrative and investment management services.

These failures, the complaints allege, have caused the plans and participants to suffer millions of dollars of losses in retirement savings, and the lawsuits seek damages to make the plans and participants whole and to reform the plan management to avoid future losses.

Having an in-depth understanding of your fiduciary obligations with respect to an ERISA-covered 403(b) plan is critical. Sponsors of 403(b) plans should review their plans' terms to ensure they understand who has been allocated fiduciary

responsibility. Fiduciaries should ensure they have in place a prudent process for assessing the plan's performance, which includes a review of investment options, expenses related to investments and plan administration, and service provider performance and fees. The fiduciary process should meet both substantive and procedural prudence requirements. Meetings should be held at least annually, and written minutes should be kept of the deliberations. If you would like some assistance understanding your fiduciary obligations, please feel free to contact a member of the Employee Benefits group.