New Wave of Retirement Fee Litigation: The University 403(b) Lawsuits

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The fiduciaries of retirement plans for 12 major universities have been hit with coordinated lawsuits asserting breaches of fiduciary duty arising from allegedly excessive fees for administrative and investment management services, imprudent selection and monitoring of recordkeepers and investment options, underperforming plan investment options, and a "paralyzing" array of investment options. Scattered across the country and brought as class actions by participants, the lawsuits target the investment governance of large Internal Revenue Code Section 403(b) retirement plans of well-known, private universities: Columbia, Cornell, Duke, Emory, Johns Hopkins, MIT, NYU, Northwestern, UPenn, USC, Vanderbilt, and Yale. The lawsuits were filed by the same law firm known for beginning the initial wave, in 2006, of 401(k) fee lawsuits. The cases are in the early pleading stage with motions to dismiss, amended complaints, and motions to dismiss the amended complaints filed in most of the lawsuits.

What are 403(b) Plans?

403(b) plans are retirement plans available only to employees of certain educational, charitable, or religious organizations that are non-profits. While the plans are defined contribution, individual account plans where participants can direct the investment of their account, 403(b) plan assets can, in general, only be invested in annuities or a custodial account invested in mutual funds.

What Are the Participants' Basic Allegations About the University Plans?

The participant-plaintiffs start from the premise that the plans at issue are "jumbo" plans that have billions of dollars in assets and tens of thousands of participants and, consequently, the bargaining power to demand low-cost administrative and investment management services. They allege that the universities and other fiduciaries of the plans failed to use the plans' billion-dollar negotiating power and, instead, paid unreasonable and excessive fees for recordkeeping, administrative, and investment services. The plaintiffs also allege that the fiduciaries selected and retained investment options that consistently and historically underperformed their benchmarks and charged excessive investment management fees. Among the relief plaintiffs seek is the restoration of losses to the plans for the alleged breaches of fiduciary duties.

The original and amended complaints are largely similar among the 12 cases. The areas of asserted failure are:

- Including investment options that are mutual funds and annuities offered by the Plan's recordkeepers
- Engaging and failing to monitor recordkeepers who earned asset-based administrative fees through revenue-sharing arrangements (rather than flat per participant fees) and who allegedly charged excessive investment management fees by tacking on fees in addition to the fees actually charged by the underlying mutual funds
- Having more than one recordkeeper and custodian or trustee for the plan, leading to inefficiencies and excessive fees
- Not conducting a competitive bidding process for the plan's recordkeeping services
- Having high-cost share classes of mutual fund investment options as opposed to institutional share classes or insurance company pooled separate accounts
- Not using the plan's bargaining power to negotiate low fees for investment management services
- Retaining historically underperforming plan investments
- Failure by the universities to monitor other plan fiduciaries
- Selecting and retaining a "dizzying array" of duplicative investment options that diluted the plan's ability to pay lower fees (because the amount of assets in any one such fund is smaller than the aggregate would have been in that investment style) and that confused participants into "decision paralysis"

This last alleged failure about decision paralysis is an allegation that was not commonly made in the ongoing 401(k) plan excessive fee litigation. The plaintiffs in the 403(b) plan litigation allege that the plan fiduciaries offered duplicative investments in every major asset class and investment style (typically 30 or more in every investment style). According to the plaintiffs, the large number of investments violated a purportedly well-recognized industry principle that too many choices can be confusing to participants and, thereby, can prevent participants from making favorable investment choices, or any decisions at all on their account (the premise being that, when people are given too many choices, they make no decision).

Universities and Their Fiduciaries Fire Back

The defendants responded to the initial complaints with motions to dismiss for failure to state a claim. Filed in all but the Columbia lawsuit,[1] the motions led to the plaintiffs' amendment of the complaints in an attempt to shore up their allegations, instead of filing any oppositions to the motions. In most of the lawsuits, the defendants have now filed motions to dismiss the amended complaints.

Among the defense arguments that the universities and their fiduciaries have made is that 403(b) plans are different from 401(k) plans in that 403(b) plans developed out of annuity products.

Annuities were the only kind of investments allowed for 403(b) plans after IRC section 403(b) was originally enacted in 1958, until ERISA was enacted in 1974. When 403(b) plan participants moved to another job, many took their existing annuity products with them, along with the existing service providers, which were in addition to the service providers of the new employer's 403(b) plan. This historical background is why many 403(b) plans have several different recordkeepers and why most 403(b) plans have multiple recordkeepers. The defendants also argue that plaintiffs have overlooked that 403(b) plans, by law, have only limited investment options available — annuities and custodial accounts investing in mutual funds, not insurance company pooled separate accounts.

A common theme in the motions to dismiss is that the participants' allegations do not allege a flawed investment decision-making process and, instead, focus solely on investment fees and performance. The university defendants maintain that the plaintiffs do not plead facts showing that the plan fiduciaries failed to evaluate the investment options at issue and, thus, provide the court with no basis to infer that the process was flawed. Some of the defendants even point out that the filing by the plaintiffs' law firm of 12 lawsuits alleging largely similar factual allegations undercuts the plaintiffs' claims of fiduciary breach, because the fiduciaries are just doing what many other fiduciaries have done under similar circumstances.

With regard to the allegation that the defendants failed to consolidate into a single recordkeeper for a plan, it is argued that minimizing fees is just one of the factors fiduciaries must consider in deciding whether to consolidate, and that the investment options alleged to be duplicative had, in fact, different objectives and performance returns. Labeling the allegations that the plans could have negotiated a more favorable arrangement with a single vendor as pure speculation, the defendants point out that ERISA does not require periodic competitive bidding, and that the plaintiffs do not allege any facts showing that a competitive bidding process would have benefited the plans.

In response to the plaintiffs' allegations that a hypothetical amount (*e.g.*, $30, $35) for a per participant fee constitutes a reasonable recordkeeping fee, and that fees should be charged as a flat per participant fee instead of as a percentage of assets, the defendants argue that these allegations are not supported by anything other than the opinion of the plaintiffs' legal counsel and that no court or government agency has required, to date, that only a flat per participant fee can be charged.

The defendants address the plaintiffs' allegations about the number and kind of investment options by presenting facts that contradict those allegations: the plaintiffs' listing of criticized funds were not in fact always investment options offered by the plans; some of the lower cost funds that plaintiffs maintain should be offered were already investment options; and some lower-cost funds have significant minimum investment requirements. Given that ERISA requires diversification of investments and encourages participant choice, the defendants explain how the university-based plans were set up with various tiers of investment options that give participants — including some of the country's brightest minds — a choice regarding how active they want to be in managing their accounts. The defendants remind the plaintiffs (and the courts) that ERISA does not require a fiduciary to scour the market to find and offer the cheapest possible fund, that there are factors other than fees to consider when choosing or maintaining investment options under a plan, and that a fund's poor performance itself is not a sufficient basis to create an inference that plan fiduciaries failed to conduct an adequate investigation.

Finally, some of the defense motions also argue that the 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.

One Case Could Head to Arbitration

Interestingly, the fiduciaries of the USC plan responded to the amended complaint filed against them not with another motion to dismiss for failure to state a claim, but instead with a motion to compel individual arbitration, requesting that the court either dismiss the case from district court on the grounds that the district court was an improper forum, or stay the case while the parties arbitrate the case. The USC participants had signed arbitration agreements that covered "all claims, whether or not arising out of Employee's University employment, remuneration, or termination," and "include, but are not limited to … claims for violation of any federal, state or other governmental law, statute, regulation or ordinance." The USC employees further agreed that final and binding arbitration would be the sole and exclusive remedy for resolving claims covered by their agreement instead of any court action, which was expressly waived by the agreement. The arbitration agreements of two of the eight participants also expressly waived any right to participate in, or bring, a class action or other collective action.

Analogies to 401(k) Plan Litigation Expected

The 403(b) plan lawsuits are early in their pleadings stages and are unlikely to be resolved any time soon. As with 401(k) plans, the process by which a fiduciary of a 403(b) plan enters into service provider arrangements, and selects and monitors investment and recordkeeping service providers, is at the heart of the lawsuits. While the cases proceed through the courts, the parties — plaintiffs and defendants alike — and the courts will undoubtedly be looking to the developing case law on 401(k) plan fees litigation for analogies and standards of fiduciary prudence.

JANUARY 2017

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[1] There were two 403(b) excessive fee lawsuits filed against Columbia within a day of each other by different law firms. The Southern District of New York granted a motion to consolidate the cases on January 24, 2017. Briefing on other matters (including any motion to dismiss or motion for leave to amend the complaint) was suspended while the motion to consolidate was pending.