What's all the fuss about university retirement plans and their fees?

If you handle fiduciary liability insurance and need a better understanding of the latest wave of fiduciary breach claims against private universities, this memo will help unravel the mystery.

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In August 2016, the Schlicter, Bogard and Denton law firm filed a dozen class action complaints against private universities nationwide relating to their 403(b) defined contribution retirement plans. These complaints, known as excessive fee claims, assert sweeping challenges to the overall costs and expenses associated with these plans. More suits have since been filed by other firms. As discussed below, the plaintiffs claim that the universities breached their ERISA fiduciary duties and committed prohibited transactions in connection with the investment options available in the plans. Although the initial wave seems to have targeted very large university 403(b) plans, the plaintiffs' appetites appear to be broadening as they look at smaller 403(b) plans. Before discussing the nature of these excessive fee claims, it's helpful to understand how these 403(b) university plans came into existence and evolved over time.

History and Background of 403(b) Plans

403(b) plans are tax-advantaged retirement plans offered by public educational institutions, nonprofit employers (e.g., research foundations, hospitals, and private educational institutions) and church organizations. Due to the unique development and regulatory history of 403(b) plans, especially those offered in the higher education space, it is not unusual for a university plan to have multiple service providers ("recordkeepers") and large investment menus. This is because many university 403(b) plans began as arrangements between an annuity provider (e.g., Teachers Insurance and Annuity Association of America and College Retirement Equities Fund or TIAA-CREF) and university personnel, and then evolved to also offer mutual funds with investment companies acting as additional recordkeepers. So now, 403(b) plans typically offer fixed and variable annuities as well as mutual funds, which when combined, results in dozens or hundreds of investment options from which plan participants can choose.

Many types of services are required to operate a 403(b) plan, including administrative services (e.g., recordkeeping and transaction processing), participant focused services (e.g., participant communication, education or advice), regulatory and compliance services, annuity processing and investment management services. The fees for these services can be levied based on the number of participants, the amount of assets (e.g., assets under management, which may include revenue sharing) or as a fixed dollar amount for the plan as a whole.

Plaintiffs' Claims and Allegations

The complaints assert ERISA breach of fiduciary duty and prohibited transaction claims, alleging that the universities failed to utilize a prudent process in managing the plans. The allegations in these suits are similar to the allegations made in the excessive fee litigation involving 401(k) plans. The plaintiffs generally allege the following:

- *Excessive recordkeeping fees*: The plaintiffs allege that the plans' fiduciaries did not negotiate favorable recordkeeping agreements with providers, but instead allowed the plans to pay asset based fees (i.e., revenue sharing)[1] that were much higher than reasonable. They also assert that

[1] Investments vehicles such as mutual funds charge fees to investors expressed as an expense ratio based on assets under management. These funds often share a portion of these asset-based fees with the plans' recordkeepers, purportedly for providing recordkeeping and administrative services for the investment. These payments can be quite large, and are not based on the number of participants in the plan.

having multiple recordkeepers, as many university plans do, led to "uncapped" asset-based revenue sharing derived from the fees participants paid in connection with the plan investments. The plaintiffs further allege that the plans failed to conduct competitive bidding processes for recordkeeping services, which caused the participants to pay higher fees than were otherwise available in the market.

- *Excessive investment management fees:* The plaintiffs allege that the investment fees charged by the various investment options in the plan investment lineup are overpriced. The plaintiffs allege that the plans offered mutual funds with more expensive share classes (e.g., retail share classes instead of institutional share classes) and selected expensive, actively managed funds instead of lower cost index funds.
- *Poor performing investment options:* The plaintiffs argue that investment options offered in the plan underperformed their benchmarks over time and should have been removed from the plan investment lineup. Plaintiffs also claim that fiduciaries failed to consider investment performance net of expense, and that when the high investment management fees are factored into the returns, the funds underperform their benchmarks.
- *Duplicative investment options:* The plaintiffs posit that the plans offered essentially duplicative investment options within asset classes, which diluted the plan's ability to obtain lower fees and confused participants. In their view, if the plans had offered fewer investment options, the plans would have increased the assets in each of those options, elevated the plans' bargaining power, and in turn achieved lower fees for each option.

Damages

Although the plaintiffs have not specifically alleged the amount of damages they seek, in each lawsuit they claim to have lost "tens of millions of dollars of retirement savings." The plaintiffs have had some success with these excessive fee claims in the context of 401(k) plans, and have survived the Motions to Dismiss decided to date on the university excessive fee claims. Outside the university context, a number of these cases have settled for $30 million or more. Additionally, excessive fee claims have historically proven to be extremely expensive to defend (costing multi-millions) and by all appearances to date the university excessive fee claims promise to follow suit.

Conclusion

University excessive fee claims unquestionably present with significant potential exposure as the Courts grapple with these cases. In the meantime, fiduciaries of university plans need to remain vigilant of this exposure, diligently manage plan expenses, and ensure appropriate risk management techniques are in place.

As a leader in the fiduciary marketplace since 1978, Chubb understands the complexities of fiduciary liability issues and has extensive experience in crafting these coverages and handling these claims. We appreciate the trust you have placed in us on behalf of your clients and look forward to serving you in the future.

Contact Us

For more information on fiduciary liability insurance, please contact your local agent or underwriting contact, or Chubb's Fiduciary Product Manager, Alison L. Martin, at almartin@chubb.com.