

Lessons for Defined Contribution Plan Fiduciaries from Current Litigation

This month, courts have been active in several of the fiduciary breach cases involving 403(b) retirement plans at private universities, including USC, Brown, New York University, the University of Pennsylvania, Duke and Northwestern. We have been closely monitoring these and other lawsuits against fiduciaries of defined contribution plans, and the lessons to be gleaned for avoiding liability.

In the last two years, over 100 lawsuits were filed against fiduciaries of 401(k) plans, primarily involving selection of investment options and other plan service providers. Similar lawsuits are targeting plans sponsored by private sector universities and tax-exempt organizations, such as hospitals and senior care facilities, with claims against plans sponsored by governmental entities conceivably to follow. We recommend that all defined contribution plan fiduciaries review the types of claims described below and schedule a review of your processes for selection of investment options and other service providers, to limit liability exposure.

403(b) Plan Litigation

Since 2016, over 20 lawsuits have been filed against private universities by the same law firm, each alleging that the fiduciaries in charge of the university's 403(b) retirement plans breached their duties to the plans—the same types of claims that have been made against 401(k) plan fiduciaries. A 403(b) plan is a tax-favored retirement plan that provides annuity contracts, and also permits participants to elect investments in mutual funds through custodial accounts. Only governmental educational organizations and tax-exempt non-profits, including entities such as private universities and hospitals, may sponsor a 403(b) plan.

The various lawsuits are based on alleged violations of the Employee Retirement Income Security Act of 1974 ("ERISA"), which applies to private 403(b) plans, but not to 403(b) plans sponsored by state-run colleges and universities. However, many of the fiduciary duties imposed by state law on sponsors and administrators of governmental plans are virtually identical to the ERISA standards. This means that all defined contribution plan fiduciaries should carefully review their processes in light of the claims underlying these new lawsuits.

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The current cases allege that fiduciaries of the universities' 403(b) plans breached their duties of prudence and loyalty under ERISA in their selection of investment options and other service providers. Many of these claims are identical, including that plans incurred losses from:

- Paying excessive fees for plan administration services
- Offering too many investment options for participants to choose from
- Using more than one recordkeeper, resulting in excessive recordkeeping fees
- Offering investment options that charged asset-based fees and used revenue sharing
- Paying fees for retail-class investment options, rather than for institutional-class options
- Retaining under-performing investments in the fund line-up, and
- Failing to engage in a competitive bidding process for plan administrative services.

The lawsuits claim that individuals who served as fiduciaries of the plans are personally liable for losses to the plans resulting from the alleged breaches.

Recent Court Activity

Last week, the Ninth Circuit ruled that [claims against fiduciaries of USC's retirement plans are not covered by arbitration agreements](#) signed by individual employees, finding that the claims were brought on behalf of the retirement plans, not employees. And earlier this month, a federal judge dismissed some but not all of the [claims brought against fiduciaries of Brown University's retirement plans](#). Both of these rulings will allow the lawsuits to go forward.

The court in the Brown University case dismissed claims involving the number of investment options offered under the University's 403(b) plans, and asset-based fee and revenue sharing arrangements. However, the court declined to dismiss several other claims, including that:

- Fiduciaries acted imprudently by using more than one recordkeeper and by failing to engage in a competitive bidding process for administrative services for the plans;
- The plans paid significantly too much for recordkeeping services compared to market rates; and
- Fiduciaries caused the plans to incur excessive investment management fees and losses by retaining expensive funds with inferior historical performance.

A similar [case against the University of Pennsylvania was dismissed](#) entirely last year, and is currently being appealed in the Third Circuit. The American Council on Education and seven other higher education associations have [filed a "friend of the court" brief in the Penn case](#), urging the court to consider the historical and structural differences between 403(b) plans sponsored by educational organizations and corporate 401(k) plans, and apply ERISA fiduciary standards in recognition of those differences.

The [case against Northwestern was dismissed](#) earlier this year, while the [case against New York University went to trial](#) in April, after some claims were dismissed last year. The [case against Duke has also been permitted to go forward as a class action](#), although the judge rejected the plaintiffs' request for a jury trial. The [case against the University of Chicago was settled](#) earlier this year for \$6.5 million.

Fiduciaries Should Review Relevant Processes and Watch for Updates

We will continue to monitor these cases and provide updates on final rulings. While public school system and governmental university plan fiduciaries are not subject to ERISA, similar fiduciary duty rules often apply under state law. While we are not aware of any similar cases against fiduciaries of governmental 403

(b) or other defined contributions plans to date, plaintiffs' attorneys may be looking at opportunities in that area.

We encourage defined contribution plan fiduciaries to undertake a review of your procedures for selecting investment options and other service providers to limit exposure to liability in this area of increased focus by plaintiffs' counsel. Please feel free to contact us if you have questions regarding your particular situation.

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