COLLEGE RETIREMENT PLAN COMPLIANCE IN A NEW ERA OF INCREASED LITIGATION

August 10, 2017

WILLIAMS MULLEN

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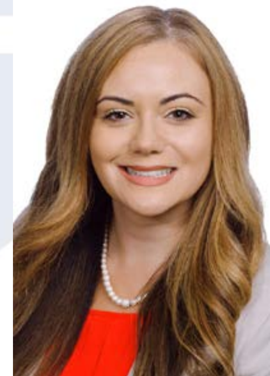

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Wednesday, October 4, 2017

8:00 AM - 8:30 AM Registration and Breakfast
8:30 AM - 1:30 PM Program

Location:
Williams Mullen's Richmond Office
Williams Mullen Center
200 South 10th Street, 15th Floor
Richmond, VA 23219

- Q&As
  - You can submit questions by using the chat feature on the left-hand side of your screen
  - We will answer your questions at the end of the program
- Please ensure that your cell phone is not close to a landline
- Following today’s discussion, you will receive an email with a link to today’s presentation.

COLLEGE RETIREMENT PLAN COMPLIANCE IN A NEW ERA OF INCREASED LITIGATION

Presented by: Brydon M. DeWitt

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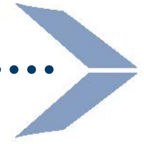
Eligible 403(b) Plan Sponsors

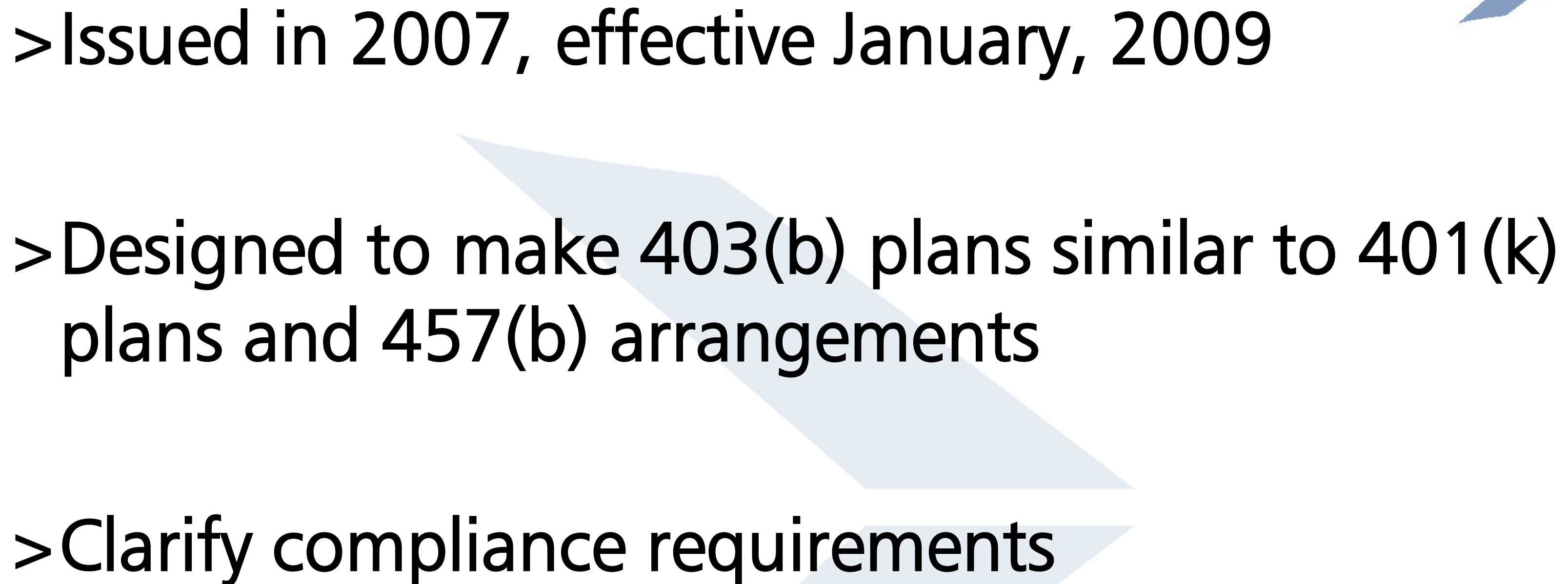


- Public education organizations
- Internal Revenue Code Section 501(c)(3) organizations
- Employer of a minister
- Self-employed ministers

History of 403(b) Plans

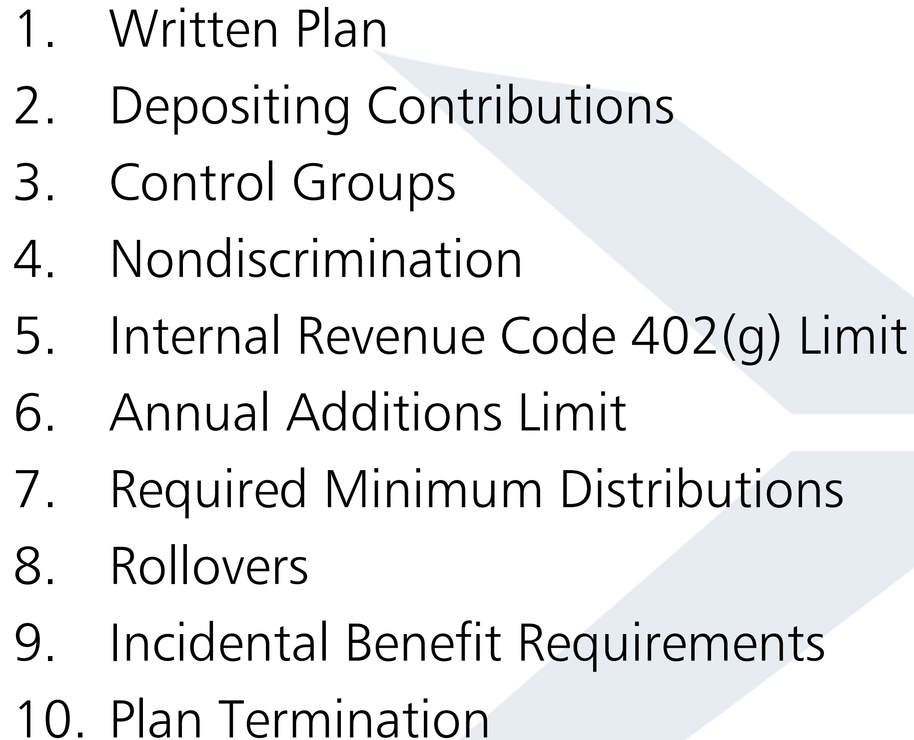
- 1958- 403(b) plans originally created for employees of tax-exempt organizations
- 1961- public education institutions became eligible to offer 403(b) plans
- 1974- ERISA adopted with terms providing for 403(b) plans

- Functioned as groups of individual annuity contracts
- Employees brought contracts and vendors with them when they changed jobs
- Employers did not assume ownership role over the plans



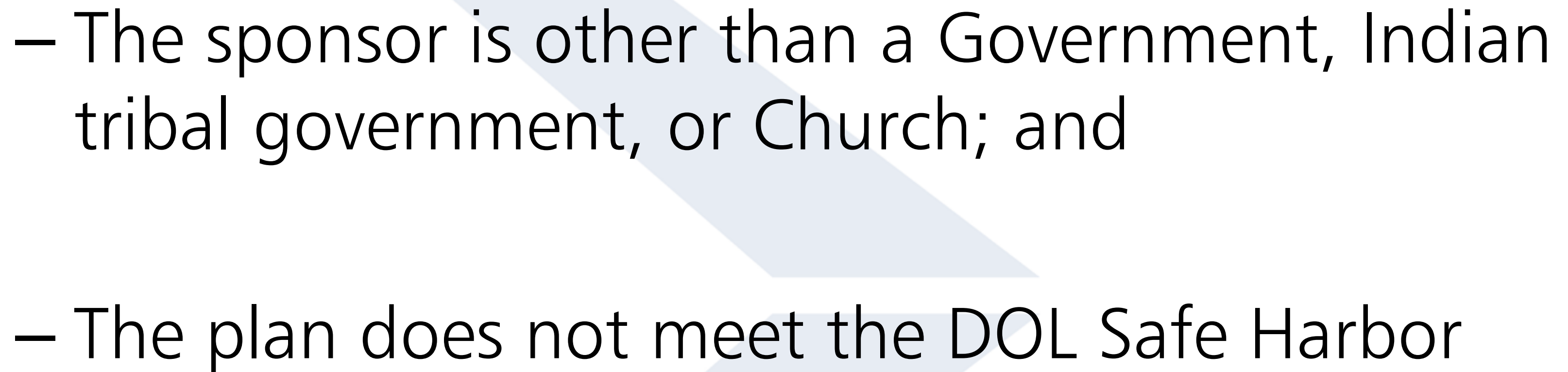
- Issued in 2007, effective January, 2009
- Designed to make 403(b) plans similar to 401(k) plans and 457(b) arrangements
- Clarify compliance requirements

Requirements for 403(b) Plans



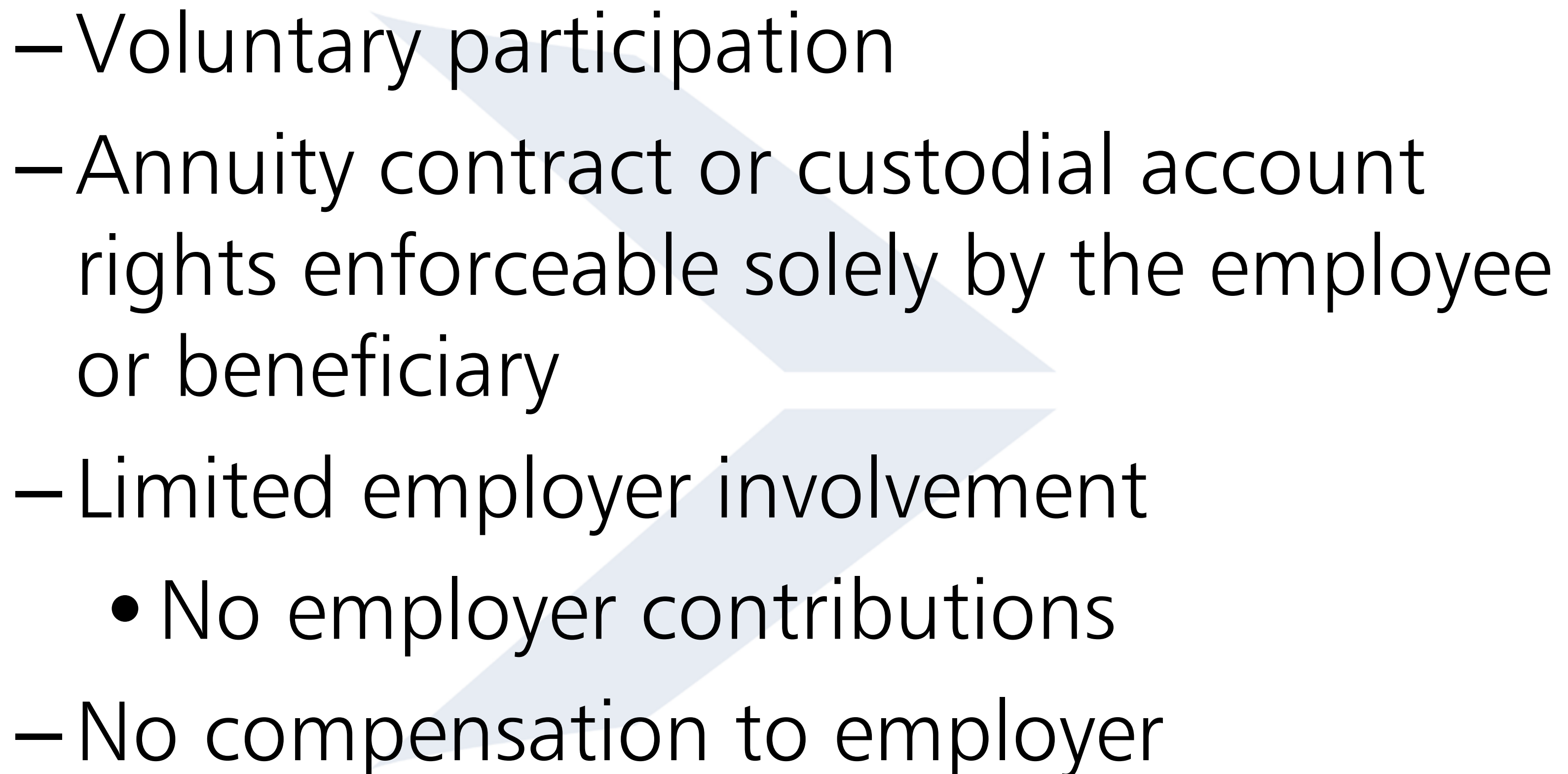
1. Written Plan
2. Depositing Contributions
3. Control Groups
4. Nondiscrimination
5. Internal Revenue Code 402(g) Limit
6. Annual Additions Limit
7. Required Minimum Distributions
8. Rollovers
9. Incidental Benefit Requirements
10. Plan Termination

>403(b) Plan may be an ERISA plan if:



- The sponsor is other than a Government, Indian tribal government, or Church; and
- The plan does not meet the DOL Safe Harbor

>DOL Safe Harbor



- Voluntary participation
- Annuity contract or custodial account rights enforceable solely by the employee or beneficiary
- Limited employer involvement
  - No employer contributions
- No compensation to employer

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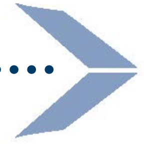
> Impact of IRS Regulations

- Increased employer responsibilities can lead to ERISA status
- DOL
  - Complying with regulations does not necessarily cause plan to be subject to ERISA
  - Must limit discretion in administering the plan
  - Employer exercising discretion regarding plan-to-plan transfers, hardship withdrawals, processing distributions, QDROs, plan loans, etc. causes plan to become subject to ERISA



> Fiduciary Duty Requirements

- A fiduciary must discharge his or her duties:
  - solely in the interest of the participants and beneficiaries;
  - for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;
  - with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiarity with such matters would use in the conduct of an enterprise of like character and with like aims;
  - by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
  - in accordance with the documents and instruments governing the plan to the extent that they comply with Titles I and IV of ERISA

- >Coordinated effort by a few plaintiffs' law firms
- >Assert breaches of ERISA fiduciary duty
- >Follows wave of 401(k) plan litigation
  - – Sued large employers, established precedent, sought settlements from smaller employers

> Universities Sued

- Yale University
- New York University
- Columbia University
- Cornell University
- University of Pennsylvania
- Duke University
- Johns Hopkins Universities
- Vanderbilt University
- Northwestern University
- University of Southern California
- Emory University
- Brown University
- University of Chicago
- Princeton University
- Washington University

403(b) Litigation

- Alleged Breaches of ERISA Fiduciary Duty
  - Offering mutual funds and annuities provided by plan recordkeepers
  - Having multiple recordkeepers, custodians, and trustees resulting in excessive fees
  - Failure to conduct a competitive bidding process for recordkeeping services
  - Offering high-cost mutual fund share classes instead of institutional share classes or insurance company pooled separate accounts
  - Failing to use the plan's bargaining power to secure lower investment management services fees
  - Offering underperforming investment options
  - Offering too many investment options, resulting in reduced bargaining power on fees and decision paralysis by participants

> Universities Respond

- Filed motions to dismiss for failure to state a claim, arguing
  - 403(b) plans are different from 401(k) plans because they arose out of annuity products
  - No allegation of flawed investment decision-making process
  - Fact that there are so many similar lawsuits demonstrates that fiduciaries were doing what other fiduciaries have done
  - Fees are only one factor in selecting recordkeepers
  - ERISA requires diversification of investments and the plans offered participants choice

> *Henderson v. Emory University*

- **Emory University Retirement Plan:** $2.6 billion net assets and 20,261 participants with account balances as of December 31, 2014
- **Emory Healthcare Inc. Retirement Savings and Matching Plan:** $1.06 billion in net asset and 21,536 participants with account balances as of December 31, 2014

- **Emory University Investment Office**
  - Develops investment strategy and policies
  - Manages plan assets
- **Emory Investment Management**
  - Selects, retains, monitors, and terminates external investment managers and investment vehicles
  - Ensures compliance with investment policies
- **Emory University Board of Trustees**
  - Oversees Emory Investment Management

> *Henderson v. Emory University*

- **Plaintiffs' claim that choosing retail-class shares over institutional class shares is imprudent**
  - Plaintiffs alleged that Emory failed to use its bargaining power to obtain lower cost fees and that the lower cost options were the same as the higher cost shares, except for the fees charged. Plaintiffs asserted that no reasonable fiduciary would choose or be complacent with being provided retail-class shares over institutional-class shares.

- **Ruling:** Plaintiffs properly stated a claim that choosing retail-class shares over institutional-class shares is imprudent.

> *Henderson v. Emory University*

- **Plaintiff's allegation that Emory offered too many investment options**
  - Plaintiffs claimed that Emory
    - offered 111 investment options, many of which were duplicative
    - should have offered fewer options and used more bargaining leverage with those investment options to obtain lower fees
  - **Ruling:** ***Plaintiffs did not state a claim for relief.*** "Having too many options does not hurt the Plans' participants, but instead provides them opportunities to choose the investments that they prefer."

> *Henderson v. Emory University*

- **Plaintiffs' claim that Emory's use of actively managed funds was imprudent**
  - Plaintiffs claimed that
    - Plan administrators and recordkeepers required Emory to include their preferred investment lineup in the plan as investment options
    - The funds were not included based on the best interest of participants, but instead to benefit the plans' service providers
    - Plans should have an open investment architecture and not be tied to the providers' investment products
    - Emory failed to properly analyze the funds allowed in the plan
    - Emory's agreements with service providers would not allow the service providers' to be removed even if they became imprudent
  - **Ruling:** "Plaintiffs have sufficiently alleged that the defendants' process for choosing and analyzing certain funds was flawed."

403(b) Litigation

> *Henderson v. Emory University*

- **Plaintiffs' claim that the Plans' funds charged excessive fees**
  - Plaintiffs claimed that
    - the CREF Variable Annuity Accounts included unneeded layers of expense charges including: (1) an administrative expense charge, (2) a distribution expense charge, (3) a mortality and expense risk charge, and (4) an investment advisory expense charge
    - The TIAA Real Estate Account includes a fifth charge for a liquidity guarantee
    - Administrative and investment management expenses were excessive for the services provided
    - Distribution expenses charged for marketing and advertising the fund to investors are unnecessary because Emory selects the funds, participants have no choice
    - Mortality and expense risk charges only benefit participants who choose to annuitize their holdings
    - All of the expenses aid the fund companies and not participants
  - **Ruling:** Fees should benefit the participants and fund options chosen for a plan should not favor the fund provider or fiduciary over participants.

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> *Henderson v. Emory University*

- **Plaintiffs' claim that Emory acted imprudently by retaining underperforming funds**
  - Plaintiffs claimed that
    - The CREF Stock Account had a long history of underperformance compared to actively managed alternatives
    - The CREF Stock Account had excessive and unnecessary fees and consistently underperformed for years
    - The TIAA Real Estate Account had a long history of underperformance compared to the Vanguard REIT Index
  - **Ruling:** A plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones. The plaintiffs' allegations sufficiently state that Emory failed to remove the CREF Stock Account and the TIAA Real Estate Account after periods of underperformance and higher costs compared to similar funds.

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> *Henderson v. Emory University*

- Plaintiffs' claim that Emory's revenue sharing method is improper and overcompensates recordkeepers
  - Plaintiffs claimed that
    - Revenue sharing can lead to excess fees if not monitored and capped
    - Recordkeeper's fee should depend on the number of participants and not the amount of assets in the plan.
  - **Ruling:** Emory can be held accountable for failing to monitor and making sure that recordkeepers charged appropriate fees and did not receive overpayment for their services.

> *Henderson v. Emory University*

- **Plaintiffs' claim that it was imprudent to contract with three recordkeepers**
  - Plaintiffs claimed that
    - Contracting with three, instead of one, recordkeeper is inefficient and costly resulting in excessive and unreasonable fees for plan recordkeeping and administrative services
    - Emory should have put the recordkeeping services out for competitive bidding every three years
  - **Ruling:** Plaintiffs claims that a prudent fiduciary would have chosen only one recordkeeper and would have put the services out for competitive bidding is sufficient to state a claim for relief.

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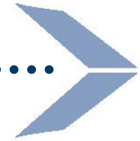
> *Henderson v. Emory University*
  - **Plaintiffs' allegation that by locking the plans into TIAA-CREF products and services, Emory breached its duty to monitor investments on an ongoing basis**
    - Plaintiffs claimed that
      - The agreement with TIAA-CREF committed the plans to include investments even if they were not longer prudent and prevented the plans from using alternative recordkeepers who could provide superior service at a lower cost
      - Emory failed to engage in reasonable decision-making regarding the prudence of investment options because the agreement bound the plan to the TIAA-CREF options
    - **Ruling:** Claims are dismissed to the extent they seek damages that occurred more than the ERISA statute of limitations period of six years prior to the compliant being filed.

> *Clark v. Duke University* and *Henderson v. Emory*

Claim	Emory	Duke
Investing in recordkeeper's mutual funds created a prohibited transaction	Dismissed	Dismissed
Locked in to TIAA-CREF investments and services	Allowed	Dismissed
Offered too many investment options	Dismissed	Allowed
Too many recordkeepers	Allowed	Allowed
Maintained underperforming and higher cost investment options	Allowed	Allowed
Failed to engage in prudent process for selecting recordkeepers	Allowed	Allowed

- > Adopt an investment policy statement
- > Hold regular (quarterly) investment committee meetings and retain minutes
  - – Review investment performance
  - – Review service provider fees
  - – Compare investments and fees to industry benchmarks
  - – Review investment options against investment policy statement
- > Ensure that plan fiduciaries understand their responsibilities
- > Offer a diverse selection of investment options, but not too many to cause confusion
- > Offer lowest-cost mutual fund shares
- > Consider consolidating recordkeepers if plan has more than one
- > Hire an independent investment advisor



QUESTIONS & ANSWERS

Please note: This presentation contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Individuals with particular needs on specific issues should retain the services of competent counsel.

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