MITIGATING FIDUCIARY RISK IN HIGHER EDUCATION RETIREMENT PLANS

Background

In the past few weeks, lawsuits were launched against twelve higher education institutions: Yale, NYU, Emory, MIT, Vanderbilt, Johns Hopkins, University of Pennsylvania, Duke, Cornell, Columbia, Northwestern, and University of Southern California. The law firm of Schlichter, Bogard & Denton filed 11 of the 12 putative class action suits, claiming breach of fiduciary duty under the Employee Retirement Income Security Act (ERISA) for providing a substandard plan model that allowed the plan participants to incur excessive fees.

Below is a summary of the major complaints issued in these lawsuits:

1. Excessive administration and service fees

There are a number of complaints here, but the underlying theme is an allegation that many plan participants are paying excessively for retirement plan administration and services. Particularly for large plans, it is alleged that the plan sponsor did not properly negotiate appropriate fees through the retirement plan recordkeeper.

2. Excessive investment fees

The majority of participant fee litigation stems from investment fees; participants claim they have been robbed of choice and forced to pay higher fees when there are lower cost options available. Plaintiffs state they could have been paying less through different share classes or passive investment management (such as index funds), or institutional fund options (such as separate accounts or collective trusts).

3. Excessive fund options

Additionally, it was argued that when an excessive number of investment options are included in the plan, many of which are expensive, this can confuse investors and negatively impact retirement readiness.

4. Proprietary fund requirements

Plaintiffs argue the inclusion of proprietary funds in plan fund line-ups only serves the interest of the plan service providers, diluting asset allocation choices by including certain real estate and stock funds that raise suitability issues.

5. Proprietary annuities liquidity issues

At least one lawsuit calls out that individual annuities' restrictions make it hard for participants to liquidate assets from those options. It gave the example of an annuity with a 2.5% surrender charge if participants withdraw their investment in a single lump sum within 120 days of termination of employment. If they want to liquidate their funds earlier, they have to pay a substantial penalty.

6. Lack of service provider monitoring

It was argued that some plan sponsors fail to perform recommended due diligence on a current provider and can become uninformed of lower cost options that may be more reasonable for participants.

7. Failure to replace underperforming funds

The suits alleges certain universities also selected and retained investment options for the plan that consistently and historically underperformed their benchmarks.

8. Multi-vendor arrangement issues

The universities all used more than one provider to operate their plans and perform the administrative services to keep them running. Here are the problems plaintiffs claim are associated with multi- vendor arrangements:

+ Loss of bargaining power. Had they consolidated to one provider, the plan sponsor could have used their bargaining power to negotiate much lower fees. Participants allege that this arrangement organically leads to higher fees when compared to consolidation under a single, total retirement outsourcing provider.
+ Multiple fees vs. single fee. When plan sponsors enter into multi-vendor arrangements, it can lead to higher participant fees as participants are paying multiple vendors as opposed to a single fee through a single provider capable of providing all retirement plan services in a bundled environment.
+ Duplicative investments. Multi-vendor arrangements implicitly mean duplicative investments in every major asset class and investment style, which plaintiffs claim can intimidate participants into "decision paralysis."

WHAT IS A FIDUCIARY UNDER ERISA?

ERISA section 3(21) defines an ERISA fiduciary as any person who:

+ Exercises discretionary authority or control over management of the plan or its assets.
+ Renders investment advice with respect to plan assets for a fee.
+ Has discretionary authority or responsibility for administering the plan.

What this means is that any person acting as a retirement plan fiduciary is required to:

+ Act in the best interest of participants and beneficiaries to eliminate or mitigate conflicts of interest when possible.

+ Treat participants and beneficiaries in a prudent and fair manner.
+ Diversify the investments of the plan so as to minimize the risk of large losses.
+ Achieve the lowest net cost consistent with the investment offered.

ERISA also expressly permits named fiduciaries to delegate some of their responsibilities to third parties (as long as the plan provides procedures for the delegation of fiduciary responsibilities). As an example, with regard to the fiduciary outsourcing services that Transamerica performs (by agreement) on behalf of the plan sponsors, Transamerica assumes fiduciary responsibility for the agreed-upon administrative procedures.

WAYS TO POTENTIALLY MITIGATE FIDUCIARY RISK

If we look back at the list of complaints these lawsuits are alleging, there are some measures that Higher Education fiduciaries can take to minimize their risks:

Implement a prudent due diligence process

This starts with plan design, investment selection and ongoing monitoring, and ongoing plan fee benchmarking.

Consider a single vs. multi-vendor plan design

This can minimize the risk of excessive investment options, loss of bargaining power on the part of the fiduciary, and duplicative investment choices for participants. Individual contracts must also be discussed since the plan sponsor has no control over these assets and a plan sponsor may question the fiduciary role in these situations.

Select an open architecture platform

A diverse investment offering can help to avoid the risk of conflicts of interest caused by proprietary funds. When your plan provider offers recordkeeping and not money management, there are built-in safeguards that prevent them from recommending funds that are in their own best interest.

Select a diverse mix of investment options

Diversity can include a fund menu made up of actively and passively managed funds. Ensure all fund classes are appropriate for investors. It's important to know all of the share classes available for a particular fund. Cases like Tibble v. Edison International illustrate the need for plan fiduciaries, as part of their prudent process, to investigate ways to ask whether institutional share classes are available for the plan.

Have a well-documented, prudent fiduciary process

This includes developing and following an investment policy statement, a written document that describes the plan's investment goals and offers guidelines about fund selection. It is unlikely that a court will decide that a breach of fiduciary duty has occurred solely because an investment option performs poorly. It is more likely to consider whether the fiduciary had a well-documented, prudent process that led to choosing and retaining the investment option.

Continually monitor and benchmark investment performance

Make changes when appropriate. Again, a well-documented process should be in place to monitor funds and state what the standards are for replacing underperforming funds. In these lawsuits, specifically named proprietary stock funds and real estate funds were cited as underperforming. In the Tibble case, the Supreme Court made clear that ERISA imposes some duty to periodically monitor plan investments.

Prudently monitor compensation received by recordkeeper

Regularly review and benchmark plan and participant fee arrangements to confirm they are reasonable and appropriate, and that the services themselves are necessary for the establishment or ongoing operation of the plan. ERISA requires plans to monitor fees to ensure they are reasonable for the services provided. This can be done through RFP, RFI, benchmarking, or some written process that demonstrates you have been prudent. An independent third-party advisor (i.e., not the recordkeeper) can be particularly helpful here.

Ensure participant education is easy to understand

Easy to understand, relevant education is the most effective way to encourage active participation, regular contributions, and well-diversified asset allocation by employees.

Work with the right partners

For plan sponsors, that means selecting both a financial advisor and a retirement plan provider who can help them fulfill their fiduciary duties, and at times share fiduciary responsibility with them.

discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. MCF is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the MCF's current written disclosure statement discussing our advisory services and fees is available upon request. If you are a MCF client, please remember to contact MCF, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services.