CLASS IS IN SESSION: LAWSUITS AGAINST HIGHER EDUCATION RETIREMENT PLANS

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Introduction

The latest round of defined contribution (DC) plan lawsuits has targeted some of the most respected universities in the United States. While large universities appear to be the primary targets, smaller universities, other 403(b) plan fiduciaries, and defined contribution plan sponsors broadly have taken interest. Many are wondering if their plan might be next. We certainly hope not—and in this paper we lend our perspective to some of the questions raised in these lawsuits.

Why Offer a Multiple-Recordkeeper Platform?

The allegations in the higher education DC plan lawsuits have a familiar tone. Similar to many of the corporate 401(k) plan lawsuits, the target of the higher education DC plan lawsuits is investment fees, recordkeeping fees, and the appropriateness of plan investments.

A differentiating characteristic of many higher education DC plans that has an important impact on fees and investments is the multiple-recordkeeper structure. Although rare among corporate 401(k) plans, offering plan participants the flexibility to invest their plan balances with more than one recordkeeper is common among higher education DC plans. Interestingly, state law requires multiple providers in some public plans.

The multiple-recordkeeper structure exists for some legacy reasons and at least one current, inescapably valid one: to offer participants access to lifetime income. Many universities offer a platform of fixed and variable annuities from an insurance provider, alongside a platform of mutual fund investments, often from a different investment manager/recordkeeper. In the higher education lawsuits, the multiple-recordkeeper models employed are combinations including, among others: TIAA and Vanguard; TIAA and Fidelity; TIAA, Vanguard and Fidelity.

With longstanding ties to insurance companies, the annuities within higher education DC plans often provide guaranteed income for life (or the participant may choose a fixed guaranteed period such as 10-, 15-, or 20-years). The appropriateness of guaranteed income options is called into question by the lawsuits.

In contrast, legislators and regulators have been actively encouraging the adoption of lifetime income solutions in defined contribution plans. Recall the public request for information (RFI) the Department of Labor and Treasury Issued in 2010 on options for facilitating access to and the use of lifetime retirement income, and the subsequent report issued by the U.S. Government Accountability Office (GAO), which considered public policy options that could require that sponsors of DC plans offer annuities as a choice to plan participants.

Why Offer an Abundance of Funds?

The story of why 403(b) plans offer large numbers of investments comes from their pre-regulation heritage of offering group and individual annuity contracts from insurance companies who only offered their own stable of investments. In order to add annuities from other providers, or expand the menu to include mutual funds, plan sponsors offered more than one provider (and their platform of funds). For example, TIAA (then TIAA-CREF) did not offer access to Fidelity funds and visa versa. To offer participants access to both, a plan sponsor had to hire multiple providers.

Let's recall that 403(b) plans started in 1958, predating ERISA by more than 15 years and 401(k) plans by more than twenty years. It was 49 years until the first comprehensive 403(b) regulations were released in July 2007, diminishing the extent to which 403(b) arrangements differ from other tax deferred plans, such as 401(k) plans. Plan sponsors and fiduciaries were given responsibilities with respect to plan documents, information sharing agreements, Form 5500 reporting, etc.

Our point with this history lesson is to challenge the notion that 403(b) and other plans for tax-exempt organizations should look like corporate 401(k) plans. Perhaps generational comparisons are appropriate, as a 60 year old has experiences to impart to a 35 year old, just as the millennial does to the senior. Our learning is that you cannot paint the different plan types (and de-

IT IS FAIRLY COMMON AMONG HIGHER EDUCATION DC PLANS TO OFFER ACCESS TO SEVERAL HUNDRED INVESTMENT CHOICES IN TOTAL

mographics) with the same brush. People who work in the nonprofit sectors often care deeply about making the world a better place, and we often find that their staff and Committees hold passionate beliefs about things like funds options ("maintain flexibility") and service levels ("high touch") that make comparisons to corporate 401(k) plans look simplistic.

What are Reasonable Recordkeeping Fees?

Recordkeeping fees in a multiple recordkeeping structure can be higher than in a single recordkeeper environment, and the lawsuits appear focused on this fee gap. But little is said about how different tax-exempt organizations are from each other (and from corporate plans), and that these differences can drive meaningful differences in recordkeeping costs. There are workers of different age, education and income levels, shift workers and unionized workers. The plan sponsors named in these lawsuits may need to demonstrate why their plan fees are reasonable, even if they are higher than similarly-sized DC plans, and we suspect that they will be able to do so.

Final Thoughts

The selection of an appropriate plan design, including the selection of the appropriate number and type of investments, is specific to the unique circumstances of the plan sponsor and their participant population. A wide range of designs can reasonably be justified based on variations in plan provisions, participant demographics, and many other factors.

What is crystal clear from the higher education lawsuits is that all defined contribution plan sponsors need to be mindful of their fiduciary obligations with selecting and monitoring plan investments, and evaluating plan fees to ensure reasonableness given the range of services provided. Having a prudent process to evaluate plan fees is critical.

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