



Welcome to the Schneider Downs Quarterly Not-for-Profit Breakfast Briefing

Recent 403(b) Fiduciary Litigation

Best Practices for Managing Fiduciary Obligations Under
Employer-Sponsored 403(b) Plans

Presented by:

Bruce Gabler, Esquire, Cohen & Grigsby, P.C.
and Karl Kunkle, Schneider Downs Tax Shareholder and
CEO, SDAdvantage Retirement Solutions

Big Thinking. Personal Focus.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

JENNIFER SWEDA, BENJAMIN A.
WIGGINS, ROBERT L. YOUNG, FAITH
PICKERING, PUSHKAR SOHONI, AND
REBECCA N. TONER, individually and as
representatives of a class of participants
and beneficiaries on behalf of the University
of Pennsylvania Matching Plan,

Plaintiffs,

v.

THE UNIVERSITY OF PENNSYLVANIA
AND JACK HEUER,

Defendants.

16 4329

Civil Action No.

COMPLAINT – CLASS ACTION

JURY TRIAL DEMANDED

2. The duties of loyalty and prudence are the “highest known to the law” and require fiduciaries to have “an eye single to the interests of the participants and beneficiaries.”

2. Billion-dollar-defined contribution plans, like the Plan, have significant bargaining power to demand low-cost administrative and investment management services.

2. Defendants allowed unreasonable expenses to be charged to participants for administration of the Plan and retained high-cost and poor-performing investments compared to available alternatives.

3. Plaintiffs bring this action on behalf of the Plan under 29 U.S.C. §1132(a)(2) and (3) to enforce Defendants' personal liability.

18. The University of Pennsylvania appointed the Vice President of Human Resources of the University of Pennsylvania to serve as the Plan Administrator under 29 U.S.C. §1002(16)(A)(i).

24. Defendants have provided as Plan investment options mutual funds and insurance company variable annuity products offered by the Teachers Insurance and Annuity Association of America and College Retirement Equities Fund (“TIAA-CREF”) and the Vanguard Group, Inc. (“Vanguard”).

25. As of December 31, 2014, Defendants selected a total of 78 investment options to provide to Plan participants. Among the available investments, 30 were TIAA-CREF investments, and 48 were Vanguard investments.

28. The TIAA Traditional Annuity has severe restrictions and penalties for withdrawal if participants wish to change their investments in the Plan.

30. The expense ratio of the CREF variable annuity accounts is made up of multiple layers of expense charges called:
- a. “administrative expense” charge (24 bps);
 - b. “distribution expense” charge (9.5 bps);
 - c. “mortality and expense risk” charge (0.5 bps);
and
 - d. “investment advisory expense” charge (ranging from 4 bps to 12.5 bps).

37. To ensure that plan administrative and recordkeeping expenses are and remain reasonable for the services provided, prudent fiduciaries of large defined contribution plans put the plan's recordkeeping and administrative services out for competitive bidding at regular intervals of approximately three years.

38. The cost of recordkeeping services depends on the number of participants, not on the amount of assets in the participant's account.

40. In a revenue sharing arrangement, a mutual fund or other investment vehicle directs a portion of the expense ratio—the asset-based fees it charges to investors—to the plan’s recordkeeper.... Because revenue sharing payments are asset-based, they often bear no relation to a reasonable recordkeeping fee and can provide excessive compensation, or may be used as kickbacks to induce recordkeepers to have their high priced funds included as plan investment options.

43. It is well known in the defined contribution plan industry that plans with dozens of choices and multiple recordkeepers “fail” as a model based on two primary flaws:

1. **The choices are overwhelming**. Numerous studies have demonstrated that when people are given too many choices of anything, they lose confidence or make no decision.
2. **The multi-recordkeeper platform is inefficient**. It does not allow sponsors to leverage total plan assets and receive appropriate pricing based on aggregate assets.

45. In a study titled “How 403(b) Plans Are Wasting Nearly \$10 Billion Annually, and What Can Be Done to Fix It”, AonHewitt, an independent investment consultant, similarly recognized:

403(b) plan sponsors can dramatically reduce participant-borne costs while improving employees’ retirement readiness by:

- Reducing the number of investment options, utilizing an “open architecture” investment menu, and packaging the options within a “tiered” structure.
- Consolidating recordkeepers to improve efficiencies and reduce compliance-related risks.
- Leveraging aggregate plan size and scale to negotiate competitive pricing.

51. Upon information and belief and industry experts, the amount of revenue sharing kicked back to the TIAA-CREF recordkeeping entity for the Plan's TIAA-CREF investments is set forth below:

TIAA-CREF Investment	Revenue Share
CREF variable annuity contracts	24 bps
Premier share class of TIAA-CREF mutual funds	15 bps
Retirement share class of TIAA-CREF mutual funds	25 bps
TIAA Real Estate Account	24-26.5 bps
TIAA Traditional Annuity	15 bps

54. Based on the Plan's features, the nature of the administrative services provided by Vanguard and TIAA-CREF, the Plan's participant level (roughly 20,000), and the recordkeeping market, the outside limit of a reasonable recordkeeping fee for the Plan would have been \$700,000 to \$750,000 (or \$35 per participant with an account balance).

58. Upon information and belief, Defendants also failed to conduct a competitive bidding process for the Plan's recordkeeping services.

60. Nobel Prize winners in economics have concluded that virtually no investment manager consistently beats the market over time after fees are taken into account.

65. Indeed, funds with high fees on average perform worse than less expensive funds even on a pre-fee basis.

69. Lower-cost share class identical alternatives to the Plan's mutual funds included:

Plan Mutual Fund	Plan Fee	Identical Lower- Cost Mutual Fund	Identical Lower-Cost Mutual Fund Fee	Plan's Excess Cost
Vanguard 500 Index Fund (Signal) (VIFSX)	<u>7 bps</u>	Vanguard Institutional Index (Instl PI) (VIIIIX)	<u>2 bps</u>	250%
Vanguard Asset Allocation Fund (Inv) (VAAPX)	<u>27 bps</u>	Vanguard Asset Allocation Fund (Adm) (VAARX)	<u>19 bps</u>	42%
Vanguard Balanced Index Fund (Inv) (VBINX)	<u>26 bps</u>	Vanguard Balanced Index Fund (Instl) (VBAIX)	<u>8 bps</u>	225%

* This comparison continues for eight pages

71. The failure to select lower-cost share classes for the Plan's mutual fund options *identical in all respects* (portfolio manager, underlying investments, and asset allocation) *except for cost* demonstrates that Defendants failed to consider the size and purchasing power of the Plan when selecting share classes and failed to engage in a prudent process in the selection, monitoring, and retention of those mutual funds.

IV. Defendants selected and retained a large number of duplicative investment options, diluting the Plan's ability to pay lower fees and confusing participants.

77. Unlike Defendants, prudent fiduciaries do not select and retain numerous investment options for a single asset class and investment style.

78. In addition, providing multiple options in a single investment style adds unnecessary complexity to the investment lineup and leads to participant confusion.

81. For illustration purposes, the Plan's four large cap domestic blend investments as of December 31, 2014, are summarized below and compared to a single lower-cost alternative that was available to the Plan: the large cap blend Vanguard Institutional Index Fund-Instl. Plus (VIIIIX), which mirrors the market and has an expense ratio of 2 bps.

Large Cap Blend Investments	Assets	Plan Fee	Lower-Cost Alternative Fee	Plan's Excess Cost
CREF Stock Account	\$753,152,128	<u>46 bps</u>	<u>2 bps</u>	2200%
CREF Equity Index Account	\$86,587,630	<u>37 bps</u>	<u>2 bps</u>	1750%
Vanguard Institutional Index Fund-Instl (VINIX)	\$120,459,283	<u>4 bps</u>	<u>2 bps</u>	100%
Vanguard Total Stock Market Index Fund-Instl (VITSX)	\$64,508,300	<u>4 bps</u>	<u>2 bps</u>	100%
Total	\$1,024,707,341			

90. Overall, Defendants failed to pool the assets invested in duplicative funds into a single investment option.

94. As is generally understood in the investment community, passively managed investment options should be used. This is because it is difficult and extremely unlikely to find actively managed mutual funds that outperform a passive index, net of fees, particularly on a persistent basis.

* This continues for 20 pages

124 c. Schlichter, Bogard & Denton handled the only full trial of an ERISA excessive fee case, resulting in a \$36.9 million judgment for the plaintiffs that was affirmed in part by the Eighth Circuit. *Tussey v. ABB Inc.*, 746 F.3d 327 (8th Cir. 2014).

128. If a defined contribution plan overpays for recordkeeping services due to the fiduciaries' “failure to solicit bids” from other recordkeepers, the fiduciaries have breached their duty of prudence.

130. Moreover, Defendants failed to solicit competitive bids from vendors on a flat per-participant fee.

131. Total Plan losses will be determined at trial after complete discovery in this case and are continuing.

132. Each Defendant is personally liable under 29 U.S.C. §1109(a) to make good to the Plan any losses to the Plan resulting from the breaches of fiduciary duties alleged in this Count and is subject to other equitable or remedial relief as appropriate.

The lawyer, Jerome J. Schlichter, is a pioneer in retirement plan litigation. Over the last decade, he has filed more than 20 lawsuits on behalf of workers in 401(k) retirement plans.

Mr. Schlichter's firm has settled about half of his 20 cases over the last 10 years. His first case involving a 403(b) was against Novant Health, a nonprofit hospital system, which settled last year for \$32 million.

M.I.T., N.Y.U. and Yale Are Sued Over Retirement Plan Fees
by Tara Siegel Bernard – August 9, 2016 (The New York Times)

Some of the more prominent cases against 401(k) plans settled by Mr. Schlichter include a \$62 million settlement against Lockheed Martin, \$57 million from Boeing, and \$27.5 million from Ameriprise, all in 2015. He also settled cases with Cigna, International Paper, Caterpillar, General Dynamics, Bechtel and Kraft.

Mr. Schlichter said his firm, which works on a contingency basis, typically collects up to a third of the settlement, while the remainder goes to the plaintiffs and members of the class.

M.I.T., N.Y.U. and Yale Are Sued Over Retirement Plan Fees
by Tara Siegel Bernard – August 9, 2016 (The New York Times)

Law 360, New York (August 19, 2016, 8:31 PM ET) – Morgan Stanley and its board were slammed with a \$150 million potential class action lawsuit in New York federal court Friday, accused of mismanaging the firm’s 401(k) retirement plan by offering low-performing funds and charging excess fees.

The lawsuit, filed in the Southern District in Manhattan, claims Morgan Stanley invests employees’ retirement savings into funds that consistently underperform, including some of the mutual funds that are run by Morgan Stanley itself.

“Morgan Stanley should be held to the highest standard as a fiduciary; instead, in this case, it falls below the lowest standard,” an attorney for the plaintiffs, David Sanford of Sanford Heisler LLP, said in a statement.

Morgan Stanley Hit With \$150M Suit Over 401(k) Management



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Best Practices For Managing Fiduciary Obligations Under 403(b) Plans

Presented by:
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SDAdvantage Retirement Plan Solutions, LP



ERISA

Employee Retirement Income Security Act of 1974

- FIDUCIARIES– Who?
- FIDUCIARY DUTY-What?
- Authorizes Employees to Sue for Breach
- Generally applies to both 401(k) plans and 403(b) plans



ERISA

- WHO?
 - Persons with responsibility for engaging service providers or appointing fiduciaries (Employer Plan Sponsor→Board of Directors→Committee)
 - Named Fiduciaries including the Trustee, ERISA 3(21) or 3(38) fiduciaries
 - Any person who has discretionary authority or control over the plan or plan assets or over the administration of the plan.



ERISA

- DUTIES
 - PRUDENCE
 - Prudent Man Standard- “..discharge duties ..with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man, acting in a like capacity and familiar with such matters would use...”
 - Engagement of professional advisors
 - PROCESS (not results), therefore, document process and implementation of process



Summary of Litigation Issues

- RECORDKEEPING
 - Asset-based (basis point % charge) fees versus per participant fixed fee
 - Multiple Recordkeepers
 - Revenue Sharing
 - Proprietary Funds with a focus on Stable Value vs Money Market
 - Float
 - Ongoing Process to Monitor Fees and Services



Summary of Litigation Issues

- INVESTMENT-BASED CLAIMS
 - Duplicative, Excessive and High-Cost Options
 - Multiple funds in each asset class
 - Lowest cost available share class?
 - Cost/Return analyses
 - Failure to provide passive/index options
 - Structure- mutual fund, annuity, separate account or CIT's
 - Capital Preservation Fund- Stable Value Fund vs. Money Market
 - Failure to have or follow a documented process to monitor and replace investment options (Investment Policy Statement)



Best Practices- Fiduciary Structure

- Professional Fiduciary– 3(38) and/or 3(21)
- Appropriate Committee Members
- Independent Advisors
- Protections
 - Fiduciary Liability Insurance
 - Corporate/Organizational Indemnification



Best Practices- Investment Policy Statement (IPS)

- Who? Identify Fiduciaries and Non-Fiduciary Advisors
- What? Identify Asset Classes
- How? Fund Selection and Monitoring Procedures
 - Thresholds: Meet Criteria, Watch List, Replace
- Periodically Review



Best Practices – Investment Selection and Monitoring

- Performance vs Benchmarks
- Asset Class Identification/Style Drift
- Expense Relative to Peers and Benchmarks
- Revenue Sharing Strategy
- Transfer Restrictions
- Share Class Optimization
- Active vs Indexing Strategy and Utilization
- Capital Preservation Fund Strategy- Stable Value vs. Money Market



Best Practices- Recordkeeping Monitoring

- Periodic RFP Process
- Benchmarking of Fees
- Evaluation of Services and Service Delivery
- Asset-Based vs Per-Participant Fixed Fees
- Revenue Sharing- Understand and Measure Application and Utilization
- Float- Understand and Monitor



Recommendations

- Read my Insight on [Schneiderdowns.com](https://schneiderdowns.com) for a short summary on this topic or contact me or your SD representative for a copy
- Consider and independent Fiduciary Check Up
- Consider conducting an RFP or a Fee Benchmarking Study
- Contact me or your SD representative for more information

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