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403(b) Litigation Update

Court decisions reveal some emerging themes

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Almost two years ago, I discussed in this column a new trend: class action lawsuits brought by participants against fiduciaries of 403(b) retirement plans under the Employee Retirement Income Security Act (ERISA). Over the course of those 24 months, at least 22 403(b) lawsuits were filed. While the majority of these cases continue to slowly move through the court dockets, there have been a few notable victories by defendant fiduciaries. What follows is a summary of the current trends as well as some "lessons learned" concerning this new area of focus by plaintiffs' class action attorneys.

In many ways, 403(b) litigation resembles the familiar territory of the 401(k) litigation that has dominated the last decade or more. As a threshold matter, the plaintiffs in 403(b) litigation generally allege, among other things, that the plan fiduciaries breached the duty of prudence that they owed to the participants and the plan. Similar to claims in 401(k) litigation, plaintiffs focus on fees and usually allege that plan fiduciaries allowed the plan participants to pay too much for investment, recordkeeping and other plan services. In this regard, plaintiffs may allege that the plan fiduciaries imprudently offered "retail" instead of "institutional" share classes in the plan. Notably, 403(b) litigation plaintiffs also question the propriety of plan fiduciaries' use of revenue sharing to pay for plan administration expenses.

On the other hand, plaintiffs have used the actions brought against 403(b) plan fiduciaries to break new ground in the context of ERISA litigation. Most notably, 403(b) plaintiffs are testing the theory that fiduciaries can be imprudent for offering "too many" investment options, which can allegedly overwhelm and confuse participants. Plaintiffs are also challenging the prudence of using multiple recordkeepers, a practice they allege unnecessarily increases plan costs. Plaintiffs have even attacked the use of annuity products—which have long been a standard and, in many cases, the only, investment option in 403(b) plans—as being too expensive.

While 403(b) plaintiffs have certainly raised novel and creative theories, some courts have indicated that they are not persuaded. For example, in one case, the court dismissed the action

because it found that, on their face, allegations similar to those described above did not give rise to breaches of fiduciary duty under ERISA.

In another notable case, the parties to the litigation went through discovery. Upon reviewing the evidence, the court determined there was no support for the allegations of breach of fiduciary duty and dismissed the case. A third case went to trial, which resulted in the court holding that, notwithstanding some procedural shortcomings in plan governance, the fiduciaries did not breach their fiduciary duties.

In a number of other cases, the courts have given the green light for plaintiffs to proceed to discovery and further develop their claims.

While all of these cases are in different stages of the litigation process and none have been completely resolved, we can see certain themes emerging. First and foremost, the courts appear to be unpersuaded by the claim that making too many investment options available under a plan results in a violation of ERISA's duty of prudence. Additionally, some but certainly not all courts reject the argument that the use of revenue sharing to pay plan expenses or the use of multiple recordkeepers, "lock-in," or bundling arrangements violates ERISA.

While 403(b) litigation is certainly breaking new ground, successfully defending ERISA litigation remains, at its essence, dependent on demonstrating procedural prudence. In this respect, the courts will not conclude a breach of fiduciary duty under ERISA merely because, for example, fiduciaries retain multiple recordkeepers, offer more expensive investment options or certain share classes in the plan, or use revenue sharing rather than a flat dollar charge to participant accounts to pay plan expenses.

Plan fiduciaries for 403(b) plans can use these general principles to develop concrete action plans even in the context of 403(b) litigation. Fiduciaries should have an understanding of their plan governance structure and be able to identify all of the plan's service providers and their respective compensation. In addition, to satisfy procedural prudence, plan fiduciaries should: 1) confirm that they and other fiduciaries have the appropriate expertise to make prudent decisions that are in the best interest of participants; 2) receive appropriate training so they understand their fiduciary obligations under ERISA and the extent of their liability; 3) as needed, retain experts, e.g., an investment adviser, to assist in making fiduciary decisions; 4) meet regularly to examine various aspects of the plan, such as the investment offerings and the level of plan expenses; and 5) clearly document their fiduciary deliberations and decisions in their meeting minutes and other materials.

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