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Fiduciary Best Practices Helped NYU Win ERISA Class Action

By **Arthur Marrapese** (September 5, 2018, 2:46 PM EDT)

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On July 31, 2018, the federal court for the Southern District of New York in Sacerdote v. New York University ruled in favor of New York University in the first university 403(b) fee case to go to trial. District Judge Katherine B. Forrest's opinion in Sacerdote highlights the various fiduciary governance practices the NYU fiduciaries followed in making the decisions at issue in the case. This article summarizes the fiduciary practices and explains how they helped the NYU fiduciaries prevail at the trial level.

Background

In 2008, NYU established a committee to manage two 403(b) plans sponsored by NYU. The committee was at the relevant time (and may still be) comprised of approximately nine executive employees of NYU, including its chief investment officer, senior vice president of finance, director of benefits, and senior vice president of human resources.

Initially, record-keeping services were provided by TIAA, Vanguard and, to a lesser extent, Prudential. In 2013, TIAA became the sole service provider to one of the plans. In 2018, TIAA became the sole service provider to the other.

In 2009, the committee retained an Employee Retirement Income Security Act 3(21) investment adviser to assist in the selection and monitoring of the plan's service providers and investments.

During the period encompassed by the lawsuit, the majority of the assets of the plans (approximately 75 percent) were held in TIAA and CREF annuity contracts that were (and presumably still are) individually owned and controlled by plan participants.

The Plaintiffs Claims

The plan participants sought money damages for plan asset losses allegedly resulting from the committee's breach of ERISA's prudent fiduciary standard.

There were two claims presented. The first was that the committee imprudently managed the selection and monitoring of record-keeping vendors resulting in excessively high fees (the excessive fee claim). The second was that the committee acted imprudently by failing to remove the TIAA Real Estate

Account and the CREF Stock Account as investment options (the imprudent investment claim).

After an eight-day bench trial, Judge Forrest ruled that the plaintiffs had failed to carry their burden of establishing that the committee acted imprudently in evaluating plan fees and investments. The court also held that the plaintiffs did not carry the burden of establishing that a hypothetical prudent fiduciary would have paid less for record-keeping services and removed the allegedly imprudent investments. In other words, the court ruled that even if the committee had breached its duty of prudence, the committee could not be held liable because the breaches would not have resulted in plan losses.

In a recent post-judgment motion, the Sacerdote plaintiffs have asked the court to remove two of the committee members as fiduciaries, neither of whom was a defendant in the case. The motion is based on the judge's findings that the committee members didn't understand basic facts about the plans (e.g., the size of the assets, the fees paid by the plans); hadn't read the plan documents; did not understand that they were in fact fiduciaries; and did not understand their responsibilities under the plan and applicable law. NYU submitted a memorandum that mounts a vigorous defense of its fiduciaries arguing, among other things, that there could be no equitable relief in light of the court's finding the committee had performed its role adequately.

The court's determination with respect to the prudence claims is addressed in more detail below. The motion for injunctive relief (i.e., the removal motion) is pending.

The Excessive Fee Claim

Fiduciaries have an obligation to ensure that a plan's investment and administrative fees are reasonable relative to the services provided; are properly paid by the plan; and are consistent with the relevant service agreements.

Under Second Circuit law, a prudence claim based on excessive fees must be supported by facts that take the particular circumstances into account. [1] Further, it appears that to prove an excessive fee claim in the Second Circuit, a plaintiff needs to establish that the fees paid by the plan were outside of the range of fees paid by comparable plans receiving the same services.

The plaintiffs advanced the following arguments in support of the excessive fee claim:

1. Revenue Sharing is an Imprudent Record-Keeping Fee Model

The plaintiffs argued that the use of a revenue sharing compensation model that does not cap revenue at a particular dollar amount is an imprudent way to collect fees. The court rejected this argument, holding that the use of a revenue sharing model is not a per se violation of ERISA. In rejecting this argument, the court noted that the trial record reflects due consideration by the committee of the appropriate pros and cons of each model — flat per-participant and revenue sharing models.

2. The Committee Should Have Conducted More Frequent RFPs

The committee issued its first request for proposal, or RFP, in 2009 (which resulted in the consolidation in 2013) and its second in 2016. The plaintiffs argued that the committee should have conducted more frequent RFPs. The court ruled that a failure to conduct an RFP, or to conduct an RFP at specified intervals, is not a per se violation of ERISA. Rather, whether and how frequently to conduct an RFP is a fact-specific determination. The court found that in light of NYU's particular needs and particular

technological environment and infrastructure, the frequency of its RFP process was adequate. The court also noted that over the course of several years, NYU's record-keeping fees consistently decreased as a result of "serious — and successful — efforts" by the NYU fiduciaries to reduce record-keeping fees.

3. The RFP Process Should Have Been Extended to All Plan Assets

The plaintiffs claimed that the committee acted imprudently by limiting the RFP process to the plan's nonannuity assets (i.e., assets other than TIAA and CREF individual annuity contracts). This, they argued, prevented competitive bidding on the fees for over 75 percent of plan assets, thereby preventing potential cost reductions.

The plaintiffs' first argument was that other vendors could, in fact, administer the individual annuity contracts. The court rejected this argument, ruling that the plaintiffs did not establish that it was reasonably possible for other vendors to record-keep TIAA-CREF annuity contracts. The court noted that the plaintiffs offered no evidence that any other vendor had ever done so.

The plaintiffs argued, in the alternative, that even if no outside record-keeper could administer the individual annuity contracts, the contract values could have been "mapped" (i.e., transferred) to similar investment alternatives (e.g., institutional mutual funds) that could be record-kept by any number of other vendors. The court disagreed with the plaintiffs once again, holding that "mapping" the annuity contracts to other investment options was not legally possible because the contracts were controlled by the participants and not NYU.

4. The Committee Should Have "Frozen" the Individual Annuity Contract

The plaintiffs asserted that even if the individual annuity contracts could not be removed and replaced by more cost-effective investment options, the committee should have "frozen" the existing accounts and encouraged participants to move assets to other investments. The plaintiffs claimed that freezing the annuity investments would have given the committee leverage in negotiations to secure a lower fee arrangement. The court was not persuaded by this argument, noting that a freeze would not have eliminated TIAA-CREF's record-keeping function as long as assets remained with TIAA-CREF, and that the committee had already exercised its leverage through ongoing and rigorous fee negotiations.

5. The Committee Waited Too Long to Consolidate the Record-Keeping Function

The plaintiffs alleged that the committee waited too long to consolidate its two record-keepers into one. Noting the complexity of NYU's administrative, payroll and IT structure, the court ruled that the committee acted as quickly as possible consistent with its duty to ensure that the consolidation was prudently implemented.

6. The Plan's Record-Keeping Fees Were Not Objectively Reasonable

The court held that the plaintiffs failed to meet their burden of establishing that the plan's record-keeping fees were outside of the range of fees paid by comparable plans. The plaintiffs' expert testified that a reasonable per-participant record-keeping fee would be in the range of $27-$35 per year as compared to the fee actually paid by the plan, which allegedly ranged from a low of $140 to a high of $270 per participant. NYU's expert countered, testifying that only 40 percent of the fee paid to TIAA-CREF was for "record keeping." He also testified that the record-keeping fees charged by the TIAA traditional annuity, which required separate record keeping, should be subtracted from the total record-

keeping fees and considered separately. In sum, NYU's expert demonstrated to the satisfaction of the court that the plan's record-keeping fees (other than the TIAA traditional annuity) were less than the "hypothetical" record-keeping fees of $27-$35 per participant/per year.

The Imprudent Investment Claim

The plaintiffs alleged that the defendants failed to follow a prudent process in evaluating plan investments and imprudently retained the CREF Stock and Real Estate Account that underperformed relative to their benchmarks.

The court disagreed, ruling that between the investment adviser's advice and the guidance of the more well-equipped committee members, the committee performed its oversight role adequately. Citing to the minutes kept by the committee as evidence, the court found:

- That the committee had met with the adviser on a regular basis;
- That the investment firm had prepared detailed reports that included the fund's performance against its peers', investment objectives and risk, and expenses, manager tenure, category ranking, risk, risk adjusted return, net expense ratio, style drift, turnover ratio, and Morningstar rating; and
- That key members of the committee were fully engaged with the adviser in reviewing the adviser's reports.

Importantly, the court also held that even if the committee's investment process had been deficient, there could be no liability because the plaintiffs had failed to meet their burden of establishing that the investments significantly underperformed their benchmarks and were otherwise imprudent.

Takeaways

The court's opinion in Sacerdote emphasizes the importance of fiduciary engagement and awareness and careful adherence to a prudent process for evaluating fees and investment options.

Fiduciaries must understand the ERISA standards that govern the payment of plan fees; know how much the plan is paying; read the plan's service agreements to ensure that the fees paid by the plan are consistent with the agreements; periodically benchmark plan fees against fees paid by similar plans; and, where appropriate, solicit proposals from other service providers and vendors.

Plan sponsors need to ensure the employees they appoint to fiduciary positions understand their fiduciary duties, and possess a willingness to perform them with the diligence required by law; make sure that plan fiduciaries read the documents that govern the plan (e.g., the plan document, summary plan description, plan "charter," and investment policy statement); and implement a robust training program designed to ensure that fiduciaries understand the plan and their roles and responsibilities with respect to the plan.

Plan fiduciaries should hire an experienced investment adviser to function as a co-fiduciary or investment manager; hold meetings with the frequency required under the circumstances, which should probably be no less frequently than semi-annually; and read the adviser's reports in advance of the

meeting and be prepared to engage with the provider at the meeting.

While a fiduciary need not duplicate an expert's analysis, the fiduciary must investigate the expert's qualifications, review the records, provide the co-fiduciary with all necessary information, and determine that reliance on the expert's advice is reasonably justified under the circumstances.

Finally, fiduciaries should be sure that the minutes of their meetings accurately document decision points, the essential details of their due diligence, and the fact that the fiduciaries were actively engaged in the review of the reports prepared by the plan's advisers.

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[1] Young v. Gen. Motors Inv. Mgmt. Corp. 325 Fed. App'x. 31 (2d Cir. 2009).