

Supreme Court will Hear Northwestern University 403(b) Plan Excessive Fee Case

by Samuel J. Baldwin on July 23, 2021

The United States Supreme Court will weigh in on the spate of recent lawsuits filed against colleges and universities related to the schools' retirement plans. The Court has granted a request for review from participants in two 403(b) retirement plans sponsored by Northwestern University. The participants seek to overturn the dismissal of their lawsuit against the University related to allegedly excessive retirement plan recordkeeping and investment fees.

The Court's decision will be highly anticipated because approximately two-dozen similar lawsuits have been brought against colleges and universities in recent years. The decision may also have ramifications outside academia for how plan fiduciaries select and monitor plan service providers and the investment options provided to participants in individual account plans.

Like many of the college and university 403(b) plan suits, the plaintiffs in the Northwestern suit – current and former employees who participate in at least one of the University's two 403(b) plans – allege that Northwestern breached its fiduciary duty of prudence under ERISA. Specifically, the plaintiffs argue that the recordkeeping fees charged to participant accounts are excessive because the plan fiduciaries used multiple recordkeepers (TIAA and Fidelity), failed to adequately monitor and negotiate the fees, and failed to conduct a request for proposals for flat, per-participant recordkeeping fees, rather than asset-based fees. Additionally, the plaintiffs argue that the plans offered too many investment options – many of which underperformed or were too expensive, or both – and offered retail class shares of mutual funds when cheaper institutional class shares of identical funds were available.

The suit against Northwestern was dismissed by the U.S. District Court for the Northern District of Illinois for the plaintiffs' failure to plausibly allege a breach of fiduciary duty. On appeal, the U.S. Court of Appeals for the Seventh Circuit affirmed the dismissal. The Court of Appeals refused to second-guess Northwestern's decision-making as to the selection of recordkeepers and the structure of recordkeeping fees. The court noted that cost is not the only factor that plan fiduciaries should consider when making decisions for the plan, and specifically considered the fact that use of TIAA as a recordkeeper was required for the plans to be able to offer popular and well-performing TIAA annuity products.

In addition, the Court of Appeals disagreed with plaintiffs' claim that the investment options in the plans were imprudently selected, focusing on the fact that the plans offered a wide array of investment options and participants were free to select any of the available

investments. According to the court, the investment options offered through plans include many of the types of funds that plaintiffs described as preferable choices. Thus, the court concluded that Northwestern “cannot be faulted for leaving choice to the people who have the most interest in the outcome.”

After the plaintiffs filed a request for review by the Supreme Court, the United States Solicitor General filed a brief at the Court’s request. The Solicitor General concluded that the Seventh Circuit opinion was wrongly decided, and that the Court should hear the appeal. Specifically, the Solicitor General claims that the plaintiffs plausibly alleged that the plan fiduciaries had breached their fiduciary duty of prudence by: (1) including retail class shares of mutual funds in the plans’ investment options even though identical institutional class shares of the same funds with lower management fees were available; and (2) failing to use any of several available methods to monitor and reduce the plans’ recordkeeping fees.

According to the Solicitor General, the inclusion of more than 100 retail class mutual funds in the plan is sufficient to support a viable claim of breach of fiduciary duty. Though conceding that cost is not the only appropriate consideration in selecting funds, the Solicitor General argued that where cost is the *only* difference between funds, it is imprudent to select the higher cost alternative. The Solicitor General also took issue with the Seventh Circuit’s reasoning that a fiduciary breach did not occur because participants are free to select one of the less expensive investment options within the plans, arguing that offering some less expensive investments does not excuse a fiduciary from its obligation not to offer other investments with excessive fees. In the Solicitor General’s view, a plan fiduciary is required to consider each investment individually, as well as the overall array of investments.

The Solicitor General argued that plaintiffs’ claims related to recordkeeping fees were also sufficient to survive a motion to dismiss. Specifically, the Solicitor General noted that plaintiffs alleged that Northwestern failed to pursue any strategy to reduce recordkeeping fees (for example, “plan pricing” rebates from TIAA based on the size of the plan) and that Northwestern failed to conduct a request for proposals for recordkeeping services. The Solicitor General’s position is that these allegations are sufficient to allow the case to go forward, because they indicate a failure to monitor the recordkeeping fees, determine whether the fees are competitive, and attempt to reduce fees without experiencing diminished services.

When the Supreme Court issues its decision, it may provide clarity regarding the pleading standard for college and university 403(b) plan cases and possibly retirement plan excessive fee lawsuits generally. Clarity would likely be welcomed by colleges and universities facing similar suits, as well as any retirement plan sponsor that is evaluating its own practices and trying to establish fiduciary compliance procedures that limit the risk of litigation. Depending on how broad the Supreme Court’s decision is, it could shed light

on specific requirements related to the selection and monitoring of service providers and plan investment options, which would be of interest to all sponsors of 403(b) plans, 401(k) plans, and other individual account plans.

The Northwestern case will be heard during the Supreme Court's next term beginning in October. Oral arguments have not yet been scheduled, and it could take some time for the Court to issue a decision after arguments are heard. We will follow the Northwestern case as it proceeds through the Supreme Court and offer updates and insights as it develops.



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