Retirement Plan Lawsuits: Preparing for the Storm

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Scanning internet news headlines on any given day will quickly confirm we live in litigious times … especially when it comes to money and investing. Currently, higher education is being roiled by class-action lawsuits filed against high-profile institutions, including MIT, Yale and New York University, over management of their retirement plans.

As the lawyers are deployed and the billable hours accrue, it's timely to examine how those who have responsibility for retirement plan oversight—directors, officers, trustees, plan administrators and human resources personnel—might be surprised to find their personal assets are exposed for investment decisions made by others.

These current lawsuits target universities' 403(b) plans, which are defined-contribution plans sponsored by tax-exempt employers, and the allegations fall into four breaches of fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA):

- Immoderate record-keeping plan fees
- Expensive investment plan options
- Redundant investment plan options
- Unsuitable investment plan options

Enacted in 1974, ERISA requires minimum protection standards for participants in most voluntarily established health and pension plans. In addition to requiring information about plan features and funding, ERISA also outlines fiduciary responsibilities for individuals who control, manage and administer plan assets, with a central focus on personal actions.

For example, sub-sections of ERISA stipulate that those who breach their fiduciary duties may be held personally liable for losses the plan suffers as a result and prohibit plans from providing liability relief from this personal fiduciary responsibility.

The path to protection

While many organizations will repay their fiduciaries in certain financial situations, employers or plan sponsors may not have the funds to reimburse (definitely a problem for smaller universities with less financial strength). Also remember, ERISA sets minimum protection standards for participants, but other laws, at a state level for instance, and court actions can go further in preventing reimbursement.

"Fiduciary liability insurance," allowed under ERISA, can provide a path to protection for directors, officers and administrators who may be connected to fiduciary responsibilities. It typically covers errors in discretionary functions requiring professional judgment, rather than those involving administrative tasks. Those covered errors could include failure to select a healthcare plan with a financially stable insurer, failure to select appropriate investments for a pension plan and failure to disclose information about a merger's effect on a company's benefit plans.

A common misunderstanding of fiduciary liability insurance is that it can be used to restore employee benefit plan losses when a plan sponsor or employer learns that it made an error.

As "third party" insurance, another party must file a complaint against the insured seeking damages for alleged wrongful acts resulting in a retirement plan loss or health plan error to trigger coverage. Fiduciary liability insurance would then provide for defense against the claim and payment for any covered award made against the insured up to the policy's limit of liability. This is an important point, as many higher education organizations buy policies with lower fiduciary limits than limits for other claims.

Words matter

Fiduciary liability policies vary widely, each having their own insuring agreements, exclusions and specific language that should be carefully reviewed by an attorney, insurance broker or both before a lawsuit is even on the horizon.

A policy could, for example, specify coverage for employees who make errors in day-to-day management of a sponsored plan such as *not* offering participation to qualifying individuals. But that same policy might *not* protect certain individuals making business decisions regarding a sponsored plan—like switching investment managers or deciding who does and who does not qualify to participate in the plan.

Some basic, policy terms to scrutinize closely would include:

- Definition of insured—who is covered in the chain of plan activity and oversight?
- Definition of wrongful act—what types of misconduct will and won't be covered?
- Definition of loss—what has to happen to the plan to invoke coverage?

Another policy coverage area worth a careful review is "Personal Conduct" exclusionary language. Say, for example, a fiduciary is accused of misrepresenting the employee 403(b) plan

in a manner that harms fund payouts, precipitating a lawsuit. Without specific final adjudication exclusion language to trigger coverage, the allegation of personal misconduct—misrepresentation in this case—could negate coverage and put the higher education institution (HEI) on the hook for legal defense costs from the outset.

It's also advisable to understand if the policy has panel counsel requirements—meaning insurer pre-approval on law firm and rates—and what the insurer deems reasonable defense rates if the insured decides to use different counsel.

Fiduciary liability for HEIs is a complex, nuanced exposure where trends can move fast. News of the suits against the three HEIs cited at the top of this piece broke in early August 2016. By mid-August, the list of reported suits had grown to eight.

Given the potential costs involved, it's far better to understand your potential coverage issues and address them before a litigation event hits. The good news is that U.S. litigation has provided ample case history, allowing HEIs to learn from the past and construct protection appropriate to likely exposures.

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