

MEMO# 33879

November 2, 2021

ICI Files Amicus Brief in 403(b) Fee Case Urging Supreme Court to Opine on Pleading Standard

[33879]

November 2, 2021

TO: ICI Members
Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension RE: ICI Files Amicus Brief in 403(b) Fee Case Urging Supreme Court to Opine on Pleading Standard

ICI recently filed the attached amicus brief in *Hughes v. Northwestern*,[\[1\]](#) urging the US Supreme Court to affirm the Seventh Circuit's decision and clarify for the lower courts that its well-established and common-sense pleading standards apply to excessive fee cases. This case will be the US Supreme Court's first time opining on this issue.[\[2\]](#) At issue in this appeal is whether the plaintiffs stated a plausible claim for relief against the plan fiduciaries for breach of the duty of prudence.

We understand that the Court is expected to begin oral arguments for the case in December and will likely issue a decision during the first half of 2022.

Background

The plaintiffs (participants in two 403(b) plans sponsored by Northwestern University) alleged that Northwestern University (and the Retirement Investment Committee) breached their duty of prudence under ERISA, by "paying excessive recordkeeping fees" and "offering mutual funds with excessive investment management fees."[\[3\]](#)

Regarding the investment management fees, the plaintiffs claim that the plans:

- had sufficient bargaining power to obtain lower expense ratios on funds;
- should have included only institutional share classes rather than retail share classes;
- should have consolidated numerous duplicative investment options in the plan lineup to enable plan to qualify for a lower cost share class; and
- retained high-cost and poor-performing investments compared to available alternatives.

Regarding the recordkeeping fees, the plaintiffs claim that:

- a flat annual fee (they suggest that \$35 per participant is reasonable) would have resulted in the plan paying less for recordkeeping compared with the revenue sharing arrangement;
- that the recordkeeper was compensated by revenue sharing it received due to the plans' use of higher-cost share classes of mutual funds, rather than readily available institutional share classes; and
- that they paid more because one of the plans had two recordkeepers (TIAA and Fidelity).[\[4\]](#)

The district court dismissed the complaint for failure to adequately plead a breach of the fiduciary duty of prudence, noting that low-cost index funds were available under the plans and that the Seventh Circuit has held that using revenue-sharing to pay for plan expenses does not violate ERISA. The Seventh Circuit affirmed the dismissal.

ICI's Amicus Brief

ICI's brief explains that when selecting a plan's investment lineup, fiduciaries typically make available a wide range of options because participants' needs vary significantly. The plaintiffs' opinion that the plan lineup should include only low-cost index funds disregards the nuances of constructing an investment lineup that serves the best interests of a broad array of plan participants. It is critical that fiduciaries maintain flexibility to select a variety of investment options based on a process that considers a wide variety of factors for an individual plan, not just expense ratio. Both actively managed and index funds can be excellent investment options for inclusion in defined contribution plan line-ups.

Similarly, selecting retail share classes for the purpose of covering third-party administrative expenses through revenue sharing can be a cost-effective choice for a plan. Within any defined contribution plan, there are fixed costs required to run the plan. It is important that fiduciaries have flexibility in the arrangements they select for paying for plan expenses.

ICI's brief argues that one cannot draw conclusions regarding whether a fiduciary met his or her obligations to the plan solely by looking at investment selection or whether revenue sharing was used. There is no per se right answer in term of retail versus institutional share classes or actively managed versus index funds. Therefore, a plaintiff's observation that a plan lineup includes an actively managed fund or a retail share class among the investment options, should not be sufficient to allow a case to move forward.

We are hopeful that the Court will uphold the appellate court's dismissal of the case and, in doing so, will include language in its opinion that is helpful to other fund families targeted by these suits.

Shannon Salinas
Associate General Counsel - Retirement Policy

endnotes

[1] Hughes v. Northwestern University, U.S., No. 19-1401; appealed from Hughes v. Northwestern University, 953 F.3d 980 (7th Cir. 2020).

[2] Note that in 2019, ICI filed an amicus brief on a related issue, asking the US Supreme Court to grant certiorari in Putnam Investments, LLC v. Brotherston. That case also dealt with plan investments but focused on the inclusion of proprietary fund products in the 401(k) plans. See ICI Memorandum No. 31621, dated February 21, 2019, available at <https://www.ici.org/memo31621>. At issue in that appeal is whether the plaintiffs bear the burden of proving that a fiduciary breach caused losses to the plan or whether the defendant has the burden of dis-proving that a fiduciary breach caused losses to the plan. A related second issue is whether plaintiffs can demonstrate losses simply by comparing the returns and fees of the plan's actual investment options to a hypothetical index-fund-only lineup. The Court declined to hear that case. See ICI Memorandum No. 32148, dated January 16, 2020, available at <https://www.ici.org/memo32148>.

[3] Plaintiffs also complain that they had too many investment options to choose from.

[4] TIAA-CREF required the plans to use it as record keeper for its products if the plans were going to offer the TIAA-CREF Traditional Annuity.