# FUNDS, FEES, AND ANNUITIES—A GUIDE TO 403(b) INVESTMENT OPTIONS

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**Going forward, there are a number of trends in investment options under Section 403(b) plans.**

There are more than 160,000 Section 403(b) plans nationwide, with more than 16 million participants.[1] As of 2014, these plans held $1.075 trillion in assets, invested in fixed annuities ($464 billion, 43%), variable annuities ($351 billion, 33%), and mutual funds ($260 billion, 24%).[2] Unlike qualified plans under Section 401—such as pension, profit-sharing, and 401(k) plans, which are not restricted as to investments—403(b) plans are restricted to only three investment options: annuity contracts under Section 403(b)(1); custodial accounts (i.e., mutual funds) under Section 403(b)(7); and little-used retirement income accounts for certain church plans under Section 403(b)(9).

## Background

Under Section 403 prior to 1958, any employer could establish a qualified annuity plan under which employees could defer income, subject to many of the same limitations as qualified plans under Section 401(a). Tax-exempt organizations under Section 501(c)(3), however, could establish qualified annuity plans, *subject to virtually no limitations at all.* This allowed employees of tax-exempts to readily defer tax on all of their income, without restriction. Believing that tax-exempt organizations were taking advantage of the special tax status afforded them under Section 403, Congress decided to limit the amount of income that could be deferred.[3] Thus, Section 403(b) was enacted in 1958.[4] In contrast, qualified plans did not permit tax-free deferrals of employees' income until Section 401(k) was added in 1978, effective as of 1/1/80. Even then, 401(k) plans did not proliferate until after the IRS issued proposed regulations late in 1981.

Section 403(b) plans—sometimes referred to as "tax-sheltered annuities" or "tax-deferred annuities"—were initially available only to the employees of Section 501(c)(3) organizations. The IRS ruled that public school system employees did not meet this test, but Congress believed it was unreasonable "to deny employees of a public school system the same benefit which is allowed employees of tax-exempt organizations when the Congress is prohibited under the Constitution from taxing such State activities."[5] Thus, in 1961, Section 403(b) was amended to allow employees "who perform services for an educational organization" to participate, where the employer is a governmental entity, retroactive to 1/1/58.

Originally, 403(b) plans could only invest in annuity contracts. To "provide more flexibility," the law expanded in 1974 to include "custodial accounts," which invest in mutual funds.[6] Finally, in 1982, "retirement income accounts" were added as a third funding option. The purpose of this change was to

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give church plans the flexibility to commingle their assets with other types of church accounts (see below). Both custodial accounts and retirement income accounts are treated as annuity contracts for purposes of Section 403(b).[7]

The primary advantage of a 403(b) plan compared to a 401(k) plan is that 403(b) plans are not subject to "actual deferral percentage" (ADP) nondiscrimination testing under Section 401(a)(3), nor top heavy testing under Section 401(a)(10).[8] As a result, an employer sponsoring a 403(b) plan can avoid the administrative cost of running complicated discrimination tests, and elective deferrals may be permitted when they would otherwise be treated as discriminatory under a qualified plan. Moreover, amounts contributed to a 403(b) are not aggregated with other defined contribution plans for purposes of the "limitation on contribution" test under Section 415, and so in some circumstances may offer employees additional deferral possibilities.[9] It is for these reasons that many tax-exempt employers adopt 403(b) plans rather than 401(k) plans.[10]

## Differences among funding options

This section discusses the differences between annuities, custodial accounts, and retirement income accounts, including their legal definitions, permitted investments, asset commingling, contract exchanges and transfers, distributions, excise taxes, and fees.

**Definitions.** An "annuity contract" is defined as a "contract that is issued by an insurance company qualified to issue annuities in a State and that includes payment in the form of an annuity."[11] An annuity pays a person equal, periodic installments (typically monthly or annually) over the remaining life of a person. The installment payments are determined based on actuarial assumptions regarding interest rates and the mortality of the participant (and, if applicable, his or her spouse). Annuity contracts and custodial accounts can be offered under the same 403(b) plan.

A "custodial account" is a plan (or a separate account under a plan), in which contributions are held by a bank or another qualified person,[12] provided that four conditions are met:

- All of the amounts held in the account are invested in stock of a regulated investment company.
- Certain restrictions on distributions with respect to a custodial account are satisfied.
- The assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries.
- The account is not part of a retirement income account.[13]

The amounts contributed to a custodial account, as well as the interest earned thereon, are taxed in the same manner as tax-exempt qualified plans.[14]

Finally, a "retirement income account" is a defined contribution plan established or maintained by a "church-related organization" for the employees of a "church-related organization," provided that all of the following are true:

- There is separate accounting for the retirement income account's interest in the underlying assets.
- Investment performance is based on gains and losses on those assets.
- The assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries.[15]

The plan document must also state its intention to constitute a retirement income account.[16]

For purposes of creating a retirement income account, a "church-related organization" includes any of three types of entities:

- A "church,"[17] which means a "church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches."
- A "qualified church-controlled organization," which means a church-controlled tax-exempt organization, *unless* such organization *both* (1) "offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities;" *and* (2) "normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both."
- An organization controlled by or associated with a church, as described in the "church plan" definition under Section 414(e)(3)(A).[18] Typically, this includes religiously-affiliated hospitals, nursing homes, and similar institutions that receive more than 25% of their revenue from the government or from selling goods or services.

Assets in a retirement income account can be held in a custodial account or a trust.[19]

**Permitted investments.** In 2015, 403(b) plans averaged 25 investment options. Some small plans had only a handful of options, and 12.2% of large plans (1,000-plus participants) had more than 50 options.[20] On average, colleges and universities have the most options, compared to plans sponsored by other types of employers.[21]

Annuity contracts. There are fixed annuities and variable annuities. Fixed annuities have a guaranteed interest rate, which may be adjusted periodically, and a fixed payment when the contract is "annuitized" and paid. Fixed annuities minimize risk, but may not yield a significant return. Participants do not control the investments in a fixed annuity. The insurance company holds the premiums in its general account, subject to the claims of its creditors, and invests them as it chooses.

A variable annuity allows the money to be invested in different forms, such as stocks, bonds, money market funds, and even mutual funds. The rate of return depends on the performance of the underlying investments, and there is no fixed payment at annuitization unless additional riders are purchased. The amounts invested in variable annuities, along with gains and losses, are accounted for separately from the general assets of the insurance company, and are not subject to the claims of the insurance company's general creditors.[22]

There are also individual and group annuities. An individual annuity is issued to the individual participant, and has its own terms and conditions that will apply, based on the individual contract. A group annuity, in contrast, is typically issued to the plan sponsor, with all participants joining that group annuity on the same terms as other participants. Group annuity contracts have the benefit of uniformity and may result in more favorable terms due to the plan sponsor's leverage as a large investor.

Custodial accounts. Custodial accounts must be invested in mutual funds. There are nearly 10,000 mutual funds available.[23] As with annuities, the number of funds available under a plan will typically be limited to those offered by a small number of providers. In a "passive" fund (e.g., an index equity fund), the investments are automatically selected to match a certain financial index or market and require little to no discretionary management. In 2016, more than $2.6 trillion was invested in passively-managed index funds in the United States, up from $384 billion in 2000.[24] An active fund, in contrast, has a manager or managers that use their discretion to select investments. Another type of fund is a "target date" fund, in which the investments are selected and updated to match a participant's risk profile based on a target retirement date. Between 2008 and 2016, the number of target date funds available almost doubled, from 339 to 641, and their total net assets more than quadrupled from $160 billion to $887 billion.[25]

Retirement income accounts. Retirement income accounts are not limited. They can invest in annuity contracts, custodial accounts, stock, real property, or anything else that would not constitute a breach of fiduciary duty under applicable law. The advantages of such plans are often overlooked.

**Asset commingling.** If the assets of a 403(b) plan can be pooled with the assets of other plans, a larger amount of money can be invested. This can drive down expenses, as such assets can qualify for institutional-share classes of mutual funds, which have low expense ratios but high minimum investment requirements (see below). The plan sponsor could also use the pooled assets as leverage to negotiate lower fees with investment managers and recordkeepers.

1 Plan Sponsor, "2017 Recordkeeping Survey" (2017), https://www.plansponsor.com/research/2017-recordkeeping-survey/2/.

2 403(b)wise.com, "403(b) Fact Sheet," http://403bwise.com/research.

3 S. Rep't No. 85-1983, 85th Cong., 2d Sess, 1958 U.S.C.C.A.N. 4791, 4824-28 (1958).

4 Qualified annuity plans are now governed by Section 403(a).

5 S. Rep't. 87-730, 87th Cong., 1st Sess, 1961 U.S.C.C.A.N. 3252, 3253-54 (1961).

6 This change was part of the Employee Retirement Income Security Act of 1974—ERISA. See 1974 U.S.C.C.A.N. 4670, 4827.

7 Sections 403(b)(7), Section 403(b)(9).

8 See Section 403(b)(12)(A).

9 Reg. 1.415(f)-1(f)(1) (if an employee is "in control" of an employer, this rule will not apply).

10 In addition: (1) plans sponsored by certain churches and qualified church-controlled organizations under Section 3121(w)(3) are fully exempt from nondiscrimination requirements; (2) church plans under Section 414(e)(3)(A) must satisfy the regular nondiscrimination rules, except for certain pre-ERISA requirements; and (3) plans maintained by state or local government entities are partially exempt from nondiscrimination requirements. Sections 403(b)(12)(B), Section 403(b)(12)(C).

11 Reg. 1.403(b)-2(b)(2); see also Reg. 1.403(b)-8(c)(2) (contracts excluded from the definition of an annuity contract); Reg. 1.403(b)-8(c)(3) (limited exception to state insurance company requirement for certain plans established on or before 5/17/82).

12 See Reg. 1.403(b)-8(d)(2); Section 401(f)(2).

13 Reg. 1.403(b)-8(d)(2).

14 Reg. 1.403(b)-8(d)(4).

15 Reg. 1.403(b)-9(a)(2)(i). The IRS has emphasized that both direct and indirect loans from a retirement income account to an employer violates the exclusive benefit rule. CCA 201742022.

16 Reg. 1.403(b)-9(a)(2)(ii).

17 See Section 3121(w)(3).

18 Regs. 1.403(b)-9(a)(2); Reg. 1.403(b)-2(b)(5), Reg. 1.403(b)-2(b)(6).

19 Reg. 1.403(b)-9(a)(7).

20 Plan Sponsor Council of America, "2016 403(b) Plan Survey," at 44-45 (2016), available via https://www.psca.org/2016_403b_report.

21 *Id.* at 45.

22 See ERISA section 3(17) (defining "separate account").

23 Statista, "Number of Mutual Funds in the United States From 1997 to 2016 (2017)," www.statista.com/statistics/255590/number-of-mutual-fund-companies-in-the-united-states/.

24 Collins and Duvall, "Supplemental Tables: Trends in the Expenses and Fees of Funds, 2016" (May 2017), Fig. 11, available at www.ici.org/info/per23-03_data.xls.

25 *Id.* at Fig. 9.

**EXHIBIT 1**
Circumstances Required for Distribution of Selected Types of Contributions.

| Distributable Event | All: Elective Deferrals | Annuity Contracts: Employer Contributions | Custodial Accounts: Employer Contributions and After-Tax Contributions | Retirement Income Accounts: Employer Contributions |
|---|---|---|---|---|
| Hardship | ✓ | ■ | ☒ | ■ |
| Age 59 ½ | ✓ | ■ | ✓ | ■ |
| Disability (as defined in Section 72(m)) | ✓ | ■ | ✓ | ■ |
| Death | ✓ | ■ | ✓ | ■ |
| Severance | ✓ | ✓ | ✓ | ✓ |
| Occurrence of Some Event (e.g., fixed number of years, attainment of stated age, or other "disability") | ☒ | ✓ | ☒ | ✓ |

✓ = Expressly permitted.
☒ = Not permitted.
■ = Not expressly permitted, but permissible as the "occurrence of some event."

There are three ways to commingle 403(b) plan assets. First, a single group annuity contract can be used to fund both a qualified plan and a 403(b) plan.[26] The amounts must be separately accounted for, however. Second, the assets of both a custodial account and a retirement income account can be pooled in a group trust with the assets of qualified plans, IRAs, and eligible governmental plans under Section 457(b).[27] However, because a custodial account can only be invested in mutual funds, either the group trust must invest solely in mutual funds, or the custodial account must be commingled only with other custodial accounts. The assets of each plan in the group trust must be separately accounted for.[28] Finally, retirement income account assets may be held in "a common fund with amounts devoted exclusively to church purposes (such as a fund from which unfunded pension payments are made to former employees...)."[29] Retirement income accounts have the most flexibility with respect to asset commingling.

**Contract exchanges and transfers.** The 403(b) regulations permit "contract exchanges," in which a 403(b) "contract"—which means an annuity contract, a custodial account, or a retirement income account—can be exchanged for another contract within the same plan.[30] Several requirements must be met. For example, the distribution restrictions in the new investment must be just as stringent as those in the old, and an information-sharing agreement must be entered into with the new contract provider regarding such administrative issues as the timing of distributable events. Since a retirement income account is deemed to be a 403(b) contract,[31] a contract exchange could be used to convert a retirement income account into a non-retirement income account, or vice versa.

Transfers between 403(b) plans are also permitted, provided the employee transferring the assets is an employee or former employee of the receiving plan, the employee's benefit does not decrease after the transfer, the distribution requirements in the receiving plan are no less stringent than those in the transferring plan, and the plan documents authorize such transfers.[32]

Finally, certain transfers between a 403(b) plan and a Section 401(a) qualified plan are permitted, provided each plan is maintained by the same church or convention or association of churches, and participants' benefits will not be reduced.[33] The plans may also be merged. Participants will not be taxed as a result of such transfer or merger. These rules were designed to help employers who mistakenly adopted a qualified plan instead of a 403(b) plan.

**Distribution restrictions.** Rollover contributions and after-tax contributions held under an annuity contract or a retirement income account can be distributed at any time.[34] Otherwise, elective deferrals and other contributions may only be distributed after certain events, as shown in Exhibit 1 on page 26:

Amounts invested in annuity contracts and retirement income accounts have the most flexibility. The restrictions on distributions from custodial accounts go with the assets if they are transferred to an annuity contract or retirement income account.[35] If elective deferrals are not accounted for separately, then contributions are not distributable until *the later of* the date permitted under the elective deferral rule or the date permitted with respect to the other contributions.[36]

**Section 4973 excise tax on custodial accounts.** Section 4973(a) imposes a 6% tax on excess contributions made to custodial accounts. An "excess contribution" is the amount by which an individual's contributions for a tax year exceeded the lesser of (1) the amount excludable from gross income under Section 403(b) or (2) the applicable limits under Section 415.[37] The excise tax is paid by the participant.

**Fees.** One of the most important differences between investment options—and the primary driver of current litigation against 403(b) plans—is the fees they charge. When evaluating investment options, it is important that plan fiduciaries understand what fees will or may apply, how such fees are calculated, and where the money to pay those fees comes from.

Custodial accounts / mutual funds. Numerous types of fees must be considered with custodial accounts.

*Total fees and expense ratios.* The average total fees for mutual funds—factoring in all direct and indirect costs—is around 3% of assets, but the variation across different funds will be significant.[38] Average expense ratios (i.e., all annual fund expenses expressed as a percentage of net assets) for long-term funds, weighted by the amount of assets invested in the funds, have declined sharply over the last 20 years for equity funds (1.04% to 0.63%), bond funds (0.84% to 0.51%), money market funds (0.52% to 0.18%), and hybrid funds (0.95% to 0.74%).[39]

Actively managed funds are the most expensive overall, with an asset-weighted average expense ratio of about 0.80%, down from a high of 0.98% in 2003.[40] In contrast, the asset-weighted average for index equity mutual funds (which are passively managed) was a scant 0.09%, with a simple average of 0.63%.[41] Index funds increased from just 7.5% of net assets invested in mutual funds in 2000, to 19.3% in 2016.[42] Target date funds have an asset-weighted average expense ratio of 0.51%, and a simple average of 0.89%, down from 0.67% and 1.23%, respectively, in 2008.[43]

*Sales loads.* A sales load is a commission paid to the investment broker. The amount is calculated as a percentage of the net assets initially invested in a fund and is paid either at the time of the investment (called a "front-end" sales load) or at the time the investment is withdrawn (called a "back-end" or a "deferred" sales load). Some back-end sales loads will decrease over time, eventually arriving at zero. A "level load" is a small back-end sales load of around 1% or smaller that typically disappears after a short amount of time, such as one year. Some sales loads are discounted, based on the size of an investment. Under FINRA Rule 2342,[44] it is unlawful to sell funds just below the "breakpoint"—at which a lower sales load applies—for the purpose of sharing in a higher fee. Under FINRA Rule 2341, a sales load cannot exceed 8.5%. A fund that has no sales load is called a "no load" fund. In 2016, the average front-end sales load actually paid by investors was only 1.1%.[45] In addition, about $9.1 trillion was invested in no-load funds across the country, compared to about $2.4 trillion in funds with sales loads, consisting mostly of front-end sales loads ($1.9 trillion).[46]

*Rule 12b-1 marketing fees.* Named after Securities and Exchange Commission (SEC) rule 12b-1,[47] these are fees charged by a fund to aid its "distribution." According to a 1999 survey, marketing fees are used (1) as a commission paid to financial intermediaries who direct investors to a fund (63% of 12b-1 fees); (2) for administrative services provided to investors by third parties (32%); and (3) for advertising and other sales promotion activities (5%).[48] Not all funds pay 12b-1 fees. Marketing fees are calculated as a percentage of assets invested. FINRA Rule 2341 places certain limits on marketing fees, such as a limit that an asset-based sales charge may not exceed 75 basis points

26 Reg. 1.401(f)-1.
27 See, e.g., Rev. Rul. 2011-1, 2011-2 IRB 251, Rev. Rul. 81-100, 1981-1 CB 326; Reg. 1.403(b)-8(f).
28 *See* Rev. Rul. 2011-1, *supra* note 27.
29 Reg. 1.403(b)-9(a)(6).
30 Reg. 1.403(b)-10(b)(2).
31 See, e.g., Reg. 1.403(b)-9(a)(1).
32 Reg. 1.403(b)-10(b)(3).
33 Section 414(z)
34 Regs. 1.403(b)-6(b), (i).
35 Reg. 1.403(b)-6(c).
36 Reg. 1.403(b)-6(d)(3).
37 Section 4973(c)(1).
38 Wealthfront Inc., "Mutual Fund Fees," www.wealthfront.com/research/mutual-fund-fees.
39 Collins and Duvall, "Trends in the Expenses and Fees of Funds, 2016" (May 2017), available at www.ici.org/pdf/per23-03.pdf. In 2016, the simple averages—not weighted by assets—were 1.28% (equity), 0.94% (bond), 0.23% (money market), and 1.29% (hybrid). Collins and Duvall, *supra* note 24 at Fig. 3.

(0.75%) per year, plus a "service fee" (which can also act as a marketing charge) that cannot exceed 25 basis points. One analysis estimated the average 12b-1 fee at 0.53%.[49] Overall, the majority (81%) of the gross sales of mutual funds in 2016 was of "clean shares" (i.e., funds with no sales load and no 12b-1 fees), nearly double the 46% in the year 2000.[50]

*Recordkeeping fees.* A recordkeeping fee is paid to a third party to manage participants' accounts. Recordkeeping will be required regardless of the type of investments offered under the plan. In the 403(b) context, plans have often allowed the providers of the investment products themselves to act as the recordkeepers for those products, leading to plans retaining multiple recordkeepers. The fees can be charged as a fixed percentage of plan assets invested, or as a fixed dollar amount per participant. Fixed dollar amounts now constitute a majority of recordkeeping arrangements in defined contribution plans ($57 per participant on average).[51]

Recordkeeping fees are often paid via revenue sharing arrangements, in which the company providing the plan's investment platform recovers a return payment when plan participants invest in certain options under the plan. The amount the company receives from the fund is a percentage of the net assets invested therein. If revenue sharing is insufficient to pay the recordkeeping fee, the plan must pay the difference. If the amounts are too much, the plan should have a contractual right to the excess so such amounts can be returned to the plan to benefit its participants. The plan fiduciary should monitor the recordkeeper to ensure that no more than reasonable compensation is ever paid for the recordkeeper's services.[52]

*Transaction fees.* Some funds charge a fixed dollar amount when making an investment, e.g., $50. However, many funds are "no transaction fee" (NTF) funds.

*Investment management fees.* The average investment management fee across mutual funds has been estimated at 0.42%, and at 0.69% specifically for actively managed funds.[53] Vanguard is known for providing funds with expense ratios that are typically below those for comparable funds provided by other companies.[54] As explained above, expense ratios for passive funds are far below active funds, primarily due to investment management fees.

*Redemption fees.* A redemption fee is an early withdrawal penalty. If a person invests in a fund and then takes the money out—e.g., within 30 or 90 days of the investment—the participant loses a percentage of the amount being withdrawn, limited to 2.0%.[55] A redemption fee is typically less significant than a surrender charge (the early withdrawal penalty applicable to annuities), both in terms of the applicable percentage and the time period over which it will apply. As a result, mutual funds are generally much more liquid than annuities.

**Variable annuities.** Here, too, several types of fees must be considered.

*Total fees.* According to 2012 figures, the average total fees paid on variable annuities was 2.35%, jumping to 3.4% with the inclusion of a living benefit rider.[56]

*Mortality and expense (M&E) risk charge.* This is a charge by the insurance company for assuming the risk under the annuity contract.[57] The charge can serve different purposes, from profit for the insurance company to paying a brokerage commission (some brokers are paid a "trailing" commission, which is paid in small installments over a fixed period of years or the life of the annuity). M&E charges for variable annuities are typically around 1.25% of net assets, within a range of 0.40 to 1.75%.[58]

*Administrative fees.* Administrative fees cover various administrative expenses to which the annuity gives rise, including recordkeeping. Administrative fees on variable annuities are typically around 0.15% (or $25 or $30 per year), within a range of 0.10-0.30%.[59]

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40 Collins and Duvall, *supra* note 24 generally.

41 *Id.* at Fig. 3.

42 *Id.* at Fig. 12.

43 *Id.* at Fig. 10.

44 FINRA is the abbreviation for the Financial Industry Regulatory Authority, an industry self-regulatory group. FINRA rules can be accessed at http://finra.complinet.com/.

45 *supra* at Fig. 18.

46 *Id.* at Fig. 21.

47 17 C.F.R. section 270.12b-1.

48 Investment Company Institute, "Background Information About 12b-1 Fees" (2003), www.ici.org/faqs/faq/expenses/ref_12b1_fees (last visited 9/ 22/17).

49 Wealthfront Inc., *supra* note 38.

50 Supplemental Tables, *supra* note 24 at Fig. 22.

51 NEPC, "Corporate Defined Contribution Plans Report Highest Number of Plans in a Decade with Fixed Record-Keeping Fees" (9/22/16), available at www.nepc.com/insights/corporate-defined-contribution-plans-report-highest-number-of-plans-in-a-decade-with-fixed-record-keeping-fees; NEPC, "Defined Contribution Fee Survey" (2016), https://cdn2.hubspot.net/hubfs/2529352/Blog/nepc_dc_infographic-1.jpg?t=1505929164422.

52 See U.S. Department of Labor (DOL) Adv. Op. No. 2013-03A, 2013 WL 3546834; DOL Adv. Op. No. 2003-09A, 2003 WL 21514170; DOL Adv. Op. No. 97-15A, 1997 WL 277980; DOL F.A.B. 2003-3, 2003 WL 24127777; 29 C.F.R. sections 2550.408b-2(c)(iv)(D), (e).

53 Wealthfront Inc., *supra* note 38; NEPC, *supra* note 51.

54 See, e.g., Rawson and Johnson, "2015 Fee Study: Investors Are Driving Expense Ratios Down," at 7 (2015), available at https://news.morningstar.com/ pdfs/2015_fee_study.pdf.

55 See 17 C.F.R. section 270.22c-2(a)(1)(i) (applicable to open-ended mutual funds).

56 Institute of Business & Finance, "Variable Annuity Charges" (8/14/13), http://icfs.com/financial-knowledge-center/variable-annuity-charges (last visited 9/22/17). Unlike mutual funds, reliable information about the fees charged by variable and fixed annuities is hard

*Underlying expense ratios.* The underlying investments in a variable annuity—such as mutual funds—will have their own expense ratios, in addition to the insurer's fees, and will typically fall somewhere between 0.25% and 2.00%.[60]

*Transaction fees.* As with mutual funds, fees for engaging in a transaction may be imposed by variable annuities.

*Surrender charge.* These are early withdrawal penalties for annuities. The money may go back to the salesperson as a commission on the original sale of the annuity.[61] The amount is a certain percentage of the assets being withdrawn. The percentage typically goes down over time until it hits zero, which could be as little as two years from the date of the initial investment or as much as 10 years or more. Some annuities permit a small percentage of assets (*e.g.*, 10% or 15%) to be withdrawn each year without being subject to the surrender charge. Some annuities also impose waiting periods before withdrawn funds can actually be accessed. For example, an annuity contract might state that a withdrawal request will only be paid after 12 months, or that it will be paid in annual installments over a certain number of years.

*Distribution fee.* Some annuities charge an additional fee for expenses associated with distributing annuity payments.

*Rider fees.* Annuities can have options that require extra fees, such as:[62]

- A *guaranteed minimum income benefit,* which sets a floor on the amount of the annuitant's monthly payment, regardless of investment performance.
- A *guaranteed minimum accumulation benefit,* which specifies that a contract will be valued no less than a certain minimum percentage of the original amount invested (e.g., 100%), regardless of investment performance.
- A *guaranteed minimum death benefit,* in which a beneficiary receives a minimum amount in the event the annuitant dies before the contract is annuitized.
- A *guaranteed minimum withdrawal benefit,* which guarantees that a certain percentage of the amount invested can be withdrawn from the contract each year until the original investment is recovered, regardless of investment performance.
- A *cost-of-living adjustment rider,* which allows the annuity payments to increase periodically to keep pace with inflation.
- A *liquidity guarantee,* to permit assets held in certain types of accounts (such as a real estate account) to be more readily withdrawn and transferrable.

The cost of a rider can range between 0.25 and 1.00% or more.[63]

Fixed annuities. There are two basic fees that may apply: M&E charges and surrender charges. However, the true fees may not be readily apparent. The guaranteed rate of return is determined by the annuity carrier, so it will be lower than the actual rate of return. The difference between the guaranteed and actual rates of return is kept by the insurance company, as a profit and fee. This makes the true fees more difficult to determine.

## Litigation risks

Over the last two decades or so, many 401(k) plans have been sued for various types of excessive fees. In 2016 and 2017, this litigation spread to 403(b) plans, and at least 15 lawsuits have been filed against universities and colleges sponsoring 403(b) plans.[64]

**Litigation targets.** Virtually all of the 401(k) and 403(b) excessive fee lawsuits have been brought against plans subject to ERISA. ERISA provides a well-established framework for federal lawsuits, as the substantive rules are the same for all

to come by. There do not appear to be any recent studies or surveys of annuity contracts that identify the types, amounts, and ranges of fees charged by companies.

57 SEC, "Variable Annuities: What You Should Know" (4/18/11), www.sec.gov/reportspubs/investor-publications/investorpubsvarannty.htm.html.

58 *Id.*; Anspach, "Variable Annuity Fees—If They're Too High, Your Account Will Suffer" (8/23/16), www.thebalance.com/variable-annuity-fees- to-ask-about-2389027 (range of 0.50 to 1.50%); Morningstar Office, "M&E Risk" (2017), https://admainnew.morningstar.com/webhelp/glossary_definitions/va_vl/pol_M_E_Risk.html; Annuity Digest, "Mortality and Expense Charge" (2017), www.annuitydigest.com/mortality-and-expense-charge/definition(range of 0.40% to 1.75%).

59 SEC, *supra* note 57; Anspach, *supra* note 58.

60 Anspach, *supra* note 58.

61 SEC, *supra* note 57.

62 *See, e.g.*, Insured Retirement Institute, "What Are The Different Types of Guaranteed Minimum Living Benefits?", http://irionline.org/consumer-articles/what-are-the-different-types-of-guaranteed-minimum-living-benefits-.

63 Anspach, *supra* note 58.

64 *Sacerdote v. New York Univ.,* No. 1:16-cv-06284 (S.D. N.Y., 8/9/16); *Vellali v. Yale Univ.,* No. 3:16-cv-01345 (D. Conn., 8/9/16); *Cassell v. Vanderbilt Univ.,* 3:16-cv-02086 (M.D. Tenn., 8/10/16); *Clark v. Duke Univ.,* No. 1:16-cv-01044 (M.D. N.C., 8/10/16); *Sweda v. Univ. of Pennsylvania,* No. 2:16-cv-04329 (E.D. Pa., 8/10/16); *Henderson v. Emory Univ.,* No. 1:16-cv-02920 (N.D. Ga., 8/11/16); *Kelly v. Johns Hopkins Univ.,* No. 1:16-cv-02835 (D. Md., 8/11/16); *Cunningham v. Cornell Univ.,* No. 1:16-cv-06525 (N.D. N.Y., 8/17/16); *Divane v. Northwestern Univ.,* No. 1:16-cv-08157 (N.D. Ill., 8/17/16); *Munro v. Univ. of Southern Cal.,* No. 2:16-cv-06191 (C.D. Cal., 8/17/16); *Cates v. Trustees of Col. Univ. in the City of New York,* No. 1:16-cv-06524 (S.D. N.Y., 8/18/16); *Daugherty v. Univ. of Chicago,* No. 1:17-cv-03736 (N.D. Ill., 5/18/17); *Davis v. Washington Univ. in St. Louis,* No., 4:17-cv-01641 (E.D. Mo., 6/8/17); *Sims-King v. Washington Univ. in St. Louis,* No. 4:17-cv-01785 (E.D. Mo., 6/23/17); *Short v. Brown Univ.,* No. 1:17-cv-00318 (D. R.I., 7/6/17). An additional lawsuit was brought against MIT, but that case involved a 401(k) plan, not a 403(b) plan. See *Tracey v. Mass. Inst. of Technology,* No. 1:16-cv-11620 (D. Mass., 8/9/16).

ERISA plans (although there will be some jurisdictional variation), and the federal courts have fairly uniform procedural rules. In addition, ERISA section 502(g) authorizes judges to award attorney's fees and costs to "either party." If a plan participant has "some success on the merits," a federal judge will award reasonable attorney's fees and costs almost as a matter of course, while it is extremely rare for a court to ever order participants to pay defendants' fees and costs.

An emerging area of ERISA involves the enforceability of fee-shifting provisions in a plan document. For example, a 403(b) plan might state that a participant who has some success on the merits is entitled to costs and fees; otherwise, the plan and its fiduciaries who are the defendants are entitled to fees and costs from the participant. If such a provision could be enforced under ERISA, it could reduce meritless litigation brought by participants.

Many types of 403(b) plans are not subject to ERISA. In particular:

- "Governmental plans" established or maintained for the employees of a state or local government entity.[65] Governmental plans are fully exempt from ERISA.[66] Many 403(b) plans established for public school employees may be governmental plans.
- "Church plans" established and maintained by a church or a convention of churches, or plans maintained by certain church-related organizations.[67] Church plans are fully exempt from ERISA, unless they elect to have ERISA apply.[68] Section 403(b) plans established for the employees of churches, religious schools and hospitals, and other tax-exempt organizations controlled by or associated with a church will not be subject to ERISA.
- "Deferral-only" arrangements under 29 C.F.R. section 2510.3-2(f). Under this regulation, an employer can use salary reduction agreements to permit employees to buy 403(b) annuity contracts or custodial accounts, provided certain requirements are met, such as limited employer involvement. A deferral-only arrangement can avoid complex ERISA regulations and reduce the employer's administrative expenses and liability risks.

A non-ERISA plan will not be fully insulated from litigation. For example, while there is not likely to be any fee-shifting law at the state level, punitive damages may be available. And though the fiduciary standards may be derived from state law instead of ERISA, they are likely to be very similar. ERISA plans, however, remain the more attractive target.

Litigation against 401(k) and 403(b) plans has focused on large plans, since they involve larger damages claims. In the future, excessive fee litigation may expand to smaller employers. In 2016, for example, an excessive fee lawsuit was brought against the fiduciaries of a $9 million 401(k) plan.[69] Though damages may be smaller, they may be high enough to warrant a lawsuit, particularly when legal fees and costs could be awarded under ERISA.

**ERISA fiduciary law.** ERISA claims are predominantly based on a breach of fiduciary duty. Generally, a fiduciary is any entity or person who exercises discretionary authority or control managing the plan or its assets, administering the plan, or rendering investment advice for a fee.[70] Fiduciaries can be *personally liable* to a plan and its participants for losses.[71] Individuals who help administer or advise a 403(b) plan or its participants may not even realize their status as a fiduciary under ERISA, and may have inadequate insurance protection, or no protection at all.

A fiduciary under ERISA must act: (1) "solely in the interest of participants and beneficiaries"; (2) "for the exclusive purpose" of providing benefits and defraying reasonable expenses of plan administration; (3) with reasonable care, skill, prudence, and diligence; (4) by diversifying plan investments; and (5) in accordance with plan documents and ERISA.[72] Fiduciaries also have a duty to disclose material information to plan participants.[73]

65 ERISA section 3(32).

66 ERISA section 4(b)(1).

67 ERISA section 3(33); see also *Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652 (2017) (holding that church plans under ERISA section 3(33)(C)(i) need not be established by a church); Medina v. Catholic Health Initiatives, 2017 WL 6459961 (CA-10, 2017) (plan administered by board subcommittee associated with Roman Catholic Church satisfied church plan definition).

68 ERISA section 4(b)(2).

69 See *Damberg v. LaMettry's Collision, Inc.,* No. 0:16-cv-01335 (D. Minn., 5/18/16), available at www.bloomberglaw.com/public/desktop/document/Damberg_et_al_v_LaMettrys_Collision_Inc_et_al_Docket_No_016cv0133?1506440558.

70 ERISA section 3(21)(A).

71 ERISA section 409(a)

72 ERISA section 404(a)(1).

73 See, e.g., *Braden v. Wal-Mart Stores, Inc.,* 588 F.3d 585, 598 (CA-8, 2009).

74 No. 1:16-CV-2920-CAP, 2017 WL 2558565 (N.D. Ga. 5/10/17).

75 135 S. Ct. 1823 (2015).

76 No. 1:16-cv-01044 (M.D. N.C. 5/11/17).

77 No. 2:16-cv-04329, 2017 WL 4179752 (E.D. Pa., 9/21/17).

78 No. 16-CV-6284 (KBF), 2017 WL 3701482 (S.D. N.Y. 8/25/17).

79 No. 16-CV-6488 (KBF), 2017 WL 3724296 (S.D. N.Y. 8/28/17).

80 *Sacerdote v. New York Univ.*, *supra* note 78; *Henderson v. Emory Univ.*, *supra* note 74; *Cates v. Trustees of Columbia Univ. in City of New York*, *supra* note 79; *Kelly v. Johns Hopkins Univ.*, No. CV GLR-16-2835, 2017 WL 4310229 (D. Md., 9/28/2017); *Daugherty v. Univ. of Chicago*, No. 17 C 3736, 2017 WL 4227942 (N.D. Ill., 9/22/2017); *Nicolas v. Trustees of Princeton Univ.*, No. CV 17-3695, 2017 WL 4155369 (D.N.J., 9/19/2017).

**Claims against 403(b) plans.** The claims being made against 403(b) plans include (1) imprudent investment claims, (2) annuity claims, (3) recordkeeping claims, and (4) other potential claims. The handful of decisions rendered on motions to dismiss the recent 403(b) lawsuits are discussed throughout.

Imprudent investment claims. The following types of claims relate to the selection, maintenance, and overall array of investment options under a plan.

*'Locking in' bad options.* TIAA-CREF is one of the biggest providers of investment options to tax-exempts. In the 403(b) suits, plaintiffs allege that TIAA-CREF required, as a condition of its agreement with plans, that (1) the plans offer three particular investment options even if they were no longer prudent, and (2) TIAA-CREF would perform recordkeeping services for those options. In *Henderson v. Emory Univ.*,[74] this claim was upheld under the "continuing duty" rule established by the Supreme Court in *Tibble v. Edison.*[75] Four other courts, however, have dismissed the claim based on the statute of limitations (*Clark v. Duke Univ.*[76]), because locking in the plan in such a manner was not outside the range of rational conduct (*Sweda v. Univ. of Pennsylvania*[77]), and because the locked-in options were not "plainly risky" (*Sacerdote v. New York Univ.*,[78] *Cates v. Trustees of Columbia Univ. in City of New York*[79]).

*Maintaining bad options.* In *Tibble v. Edison*, the U.S. Supreme Court held that fiduciaries have a continuing duty to monitor investment options and remove imprudent ones. In the 403(b) context, plaintiffs alleged that plans offered historically poor-performing funds when better-performing, lower-cost options in similar investment classes were available. This claim was allowed to proceed in six lawsuits,[80] while it was dismissed in *Sweda v. Univ. of Pennsylvania*, with the court emphasizing that *post-hoc* second-guessing is inappropriate. This claim has generally not fared well in the 401(k) context.[81]

*Not offering cheaper options.* Plaintiffs allege that large plans with significant assets failed to use their leverage to negotiate lower fees, and that they offered only *retail* shares (i.e., those available on the general market) instead of institutional shares, which are almost identical to retail shares but charge lower fees. The court in *Henderson v. Emory Univ.* allowed this claim to proceed, while other courts dismissed it outright because (1) the plans included some options with low fees, (2) many institutional shares were in fact offered, (3) some institutional shares were unavailable without a more significant investment by the plan, and (4) some institutional shares would come at the cost of lower liquidity.[82] This claim has had mixed results in the 401(k) context.[83]

*Excessive and duplicative options.* Plaintiffs allege the plans have so many options it results in "analysis paralysis," in which a participant is unable to make a decision due to the overwhelming options before him or her. In *Clark v. Duke Univ.*, for example, the plan allegedly included over 400 investment options. Five courts have dismissed this claim, with one stating that "[h]aving too many options does not hurt the Plans' participants, but instead provides them opportunities to choose the investments that they prefer."[84] Plaintiffs have also alleged that there were competing and duplicative options offered by several different providers, reducing a plan's ability to use its leverage to negotiate lower fees. This claim was dismissed by four courts, with the NYU court recognizing that the "duplicative" options were not actually identical.[85]

*Violation of investment policy.* Investment policy statements provide guidelines concerning the selection and removal of investment options under a plan. Only about 56% of 403(b) plans have an investment policy.[86] Plaintiffs allege that selecting and/or maintaining certain poor-performing funds in the plans breached the plan's own investment policy. This claim was allowed to proceed in *Clark v. Duke University* (though perhaps only because the defendants failed to give the court a reason to dismiss it).

*Not analyzing recordkeepers' options.* Plaintiffs allege recordkeepers required or persuaded the plans

81 *Braden v. Wal-Mart Stores, Inc.*, *supra* note 73;*Fuller v. SunTrust Banks, Inc.*, 744 F.3d 685 (CA-11) (properly dismissed, as claim was based on the exact same facts as improper initial selection of funds, which was time-barred); *Laboy v. Bd. of Trustees of Bldg. Serv. 32 BJ SRSP*, 513 F. App'x 78 (CA-2, 2013) (claim properly dismissed, as insufficient facts alleged, and no kick-back scheme alleged like that in *Braden v. Wal-Mart Stores, Inc.*,, *supra* note 73); *Young v. Gen. Motors Inv. Mgmt. Corp.*, 325 F. App'x 31 (CA-2, 2009) (claim correctly dismissed, as no allegation the fees were excessive relative to the services rendered); *Renfro v. Unisys Corp.*, 671 F.3d 314 (CA-3, 2011) (claim properly dismissed); *Goldenberg v. Indel, Inc.*, 741 F. Supp. 2d 618 (D. N.J., 2010) (bare comparison of different fees charged insufficient to state a claim for breach of fiduciary duty based on excessive fees).

82 *Sacerdote v. New York Univ., supra* note 78; *Sweda v. Univ. of Pennsylvania, supra* note 77; *Cates v. Trustees of Columbia Univ. in City of New York, supra* note 79; *Kelly v. Johns Hopkins Univ., supra* note 80.

83 *Braden v. Wal-Mart Stores, Inc., supra* note 73 (court correct in not dismissing claim); *Renfro, supra* note 81 (claim properly dismissed, as substantial diversity in investment options with varying fees and no kick-back scheme alleged as in *Braden v. Wal-Mart Stores, Inc.*); *Abbott v. Lockheed Martin Corp.*, No. 06-CV-0701-MJR, 2009 WL 839099 (S.D. Ill., 3/31/09) (dismissed, as offering retail shares available on open market "guarantee[s] a competitive expense ratio"); *Boeckman v. A.G. Edwards, Inc.*, 461 F. Supp. 2d 801 (S.D. Ill., 2006) (genuine issue as to whether plan acted reasonably).

84 *Henderson v. Emory Univ., supra* note 74; *Sweda v. Univ. of Pennsylvania, supra* note 77; *Sacerdote v. New York Univ., supra* note 78; *Cates v. Trustees of Columbia Univ. in City of New York, supra* note 79; *Kelly v. Johns Hopkins Univ., supra* note 80.

85 *Sweda v. Univ. of Pennsylvania, supra* note 77; *Sacerdote v. New York Univ., supra* note 78; *Cates v. Trustees of Columbia Univ. in City of New York, supra* note 79.

86 Plan Sponsor Council of America, *supra* note 20.

to use certain funds, without plan fiduciaries engaging in a diligent analysis of those options. This claim was allowed to proceed in *Henderson v. Emory Univ.*

*Not monitoring delegates.* Plaintiffs allege that fiduciaries failed to properly monitor those to whom they delegated their fiduciary duties. This claim was dismissed in *Nicolas v. Trustees of Princeton Univ.*, *Clark v. Duke University*, *Sacerdote v. New York Univ.*, and *Cates v. Trustees of Col. Univ. in the City of New York* because there were no facts alleged in support.

**Annuity claims.** The following types of claims are particular to annuity contracts.

*Surrender charges and withdrawal restrictions in fixed annuities.* Plaintiffs allege that funds could only be withdrawn from a fixed annuity: (1) in ten annual installments, without penalty; (2) in a lump sum within 120 days after termination of employment without penalty; or (3) otherwise, subject to a 2.5% surrender charge. Plaintiffs argue that these withdrawal restrictions made it unreasonably difficult or harmful for participants to withdraw from the fixed annuity and invest elsewhere, and that these restrictions violated applicable regulations.[87]

*Unnecessary fees.* Plaintiffs allege that some annuities charged a distribution fee of around 0.1% and an M&E charge, which only benefit participants who elect to annuitize at retirement. Plaintiffs also allege unreasonably high investment management and administrative fees in the annuities. These claims were allowed to proceed in *Henderson v. Emory Univ.* In *Sacerdote v. New York Univ.* and *Cates v. Trustees of Columbia Univ. in City of New York,* the court dismissed all claims related to fee layering, since there the plaintiffs did not allege that these individual fees resulted in higher fees overall.

*Separate accounts are too expensive.* Plaintiffs allege that a particular variable annuity—the TIAA Real Estate Account—required the hiring of an independent fiduciary to review and approve certain transactions engaged in by the fund (primarily for the purpose of creating liquidity).[88] This naturally added to the expenses.

*Fixed annuities rely on insurance company general accounts.* Plaintiffs include allegations hinting that it may be imprudent to invest in fixed annuities backed only by insurance company general accounts, but do not specifically raise the issue in their counts.

**Recordkeeping claims.** Recordkeeping arrangements are a major risk area for 403(b) plans. These claims are framed in numerous ways, most of which have been allowed to proceed, except as noted below:

- Failing to solicit competitive bids from recordkeepers.
- Failing to use leverage as a large plan to negotiate lower fees.
- Paying a fee that is a percentage of plan assets instead of a fixed amount per participant, or paying a per-participant fee that is unreasonably high. In *Sweda v. Univ. of Pennsylvania,* the court dismissed this claim, holding that a percentage-based recordkeeping fee is more equitable to participants than a per-participant fee, which disproportionately impacts participants with small accounts.
- Paying the recordkeeping fee through revenue sharing payments that exceed reasonable compensation for the services actually provided.
- Paying for multiple recordkeepers instead of a single recordkeeper. In *Sweda v. Univ. of Pennsylvania,* the claim was dismissed, since using multiple recordkeepers in order to gain access to a company's investment platforms "is not inconsistent with lawful, free market behavior in the best interests of those involved, including beneficiaries."
- Failing to monitor the recordkeeping fees to ensure that no more than reasonable compensation is paid.

[87] See 29 C.F.R. section 2550.408b-2(c)(3) ("No contract or arrangement is reasonable ... if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous").

[88] See Individual Prohibited Transaction Exemption (PTE) 96-76, 61 Fed. Reg. 54,229 (1996)

[89] See, e.g., *Dezelan v. Voya Ret. Ins. & Annuity Co.,* No. 3:16-CV-1251, 2017 WL 2909714 (D. Conn. 7/6/17) (dismissing the claim, unable to conclude based on allegations that the carrier retained the "spread," i.e., the difference between the crediting rate and the actual rate of return); Rozo v. Principal Life Ins. Co., No. 4:14-cv-000463, 2017 WL 2292834 (S.D. Iowa, 5/12/17).

[90] See, e.g., *Chendes v. Xerox HR Solutions, LLC,* No. 2:16-cv-13980 (E.D. Mich., 11/9/16); *Fleming v. Fidelity Management Trust Co.,* No. 1:16-cv-10918 (D. Mass., 5/20/16); *Scott v. Aon Hewitt Financial Advisors, LLC,* No. 1:17-cv-00679 (N.D. Ill., 1/2717); *Patrico v. Voya Fin., Inc.,* No. 16 CIV. 7070 (LGS), 2017 WL 2684065 (S.D. N.Y. 6/20/17) (dismissing all claims but granting leave to re-file); Green v. Morningstar, Inc., No. 1:17-cv-05652 (N.D. Ill., 8/3/17), complaint available at www.planadviser.com/uploadedFiles/GreenvMorningstarPrudentialComplaint.pdf.

[91] *Lefkowitz v. Teachers Ins. and Annuity Assn.,* No. 1:16-cv-01932 (S.D. N.Y. 3/15/16); see also Adams, "The Latest Excessive Fee Suit ... Excessive Participant Mailings" (3/17/16), www.napa-net.org/news/technical-competence/erisa/the-latest-excessive-fee-suit-excessive-participant-mailings/.

[92] See, e.g., *Braden v. Wal-Mart Stores, Inc., supra* note 73 (claim stated, as such information was "material" and could have been used by a reasonable employee to make adequately informed decisions under the plan); but see *Hecker v. Deere & Co.,* 556 F.3d 575 (CA-7, 2009) (no duty to disclose that fund fees also paid recordkeeping fees of fund manager's affiliated entity, as no duty to disclose how the money is allocated, plus the prospectuses may have disclosed that info); *Abbott v. Lockheed Martin Corp., supra* note 83 (dismissed, as only the total fee is material, not any revenue sharing arrangements with respect to that fee).

[93] Plan Sponsor Council of America, *supra* note 20.

Section 403(b) plan fiduciaries should evaluate recordkeeping arrangements to ensure they are reasonably structured and administered.

**Other potential claims.** In addition to the claims brought in the 403(b) lawsuits, there are numerous other types of claims 403(b) plans should be concerned about, including:

- Annuity carriers intentionally setting artificially low crediting rates for their products, in order to extract an unreasonably high fee and profit for their services.[89]
- "Robo-advising," in which investment advice is provided to plan participants through automated systems. Several lawsuits have been brought against plan fiduciaries and robo-advisors, alleging: (1) a breach of fiduciary duty based on unreasonably high fees for the services; (2) a breach of fiduciary duty and prohibited transactions based on payments paid to the recordkeeper that offered the services; and (3) even an unlawful racketeering scheme designed to steer participants "into high-cost investments that pay unwarranted fees to Defendants."[90]
- Excessive and costly mailings to participants.[91]
- A failure to disclose material information concerning fees, such as the existence of a revenue-sharing arrangement, or the total amount or percentage being paid for recordkeeping and other fees.[92]

As explained above, clean shares now constitute a majority of gross sales of funds. The failure to take a serious look at clean shares and remove other options could be actionable.

## Conclusion

Going forward, there are a number of trends in investment options under Section 403(b) plans—i.e., annuity contracts, custodial accounts, and retirement income accounts. First, given the large number of employees eligible to participate in 403(b) plans, an increasing wage base, and the favorable design advantages of 403(b)s over 401(k)s, money will continue to pour into 403(b) investment options.

Second, while annuity contracts were once the only option—and still constitute a majority of the total assets nationwide—there is a strong trend toward offering mutual funds as an alternative to annuities. In 2015, for example, while 87.1% of 403(b) plans offered mutual funds as an investment option, only 58.6% offered annuities.[93] Assets are likely to continue to migrate from annuity contracts to custodial accounts.

Third, additional investment options are not likely to be permitted anytime soon. Congress seems content to leave the investment restrictions as they are, and there are no strong calls for change, despite the availability of unrestricted investments in qualified plans.

Fourth, 403(b) plans will continue to be the subject of litigation. This is due to the aggregate size of assets invested and the complexity of how employers structure their relationships with providers. Plans of all sizes should monitor how the litigation proceeds, as trends in court decisions can serve as guideposts for how any plan's investment options and recordkeeping arrangements should be structured.

Finally, owing in part to the recent litigation, 403(b) plan sponsors will continue to be under pressure to monitor their expenses and fees, and to scrutinize their arrangements with service providers. ■