Supreme Court Ruling Clarifies 401(k) Plan Fiduciary Responsibilities

The U.S. Supreme Court has clarified the scope of potential fiduciary liability by holding that the duty of a broadened fiduciary does not end with fund selection, but extends to ongoing monitoring of plan investments.

In a case closely watched by the retirement plan industry, the U.S. Supreme Court recently confirmed in *Tibble v Edison International (Tibble)* that the responsibilities of plan fiduciaries do not stop at selecting appropriate funds for their plan, but also require that plan investments be monitored on a regular basis and replaced, when necessary.

The *Tibble* lawsuit was filed on behalf of current and former participants in Edison International’s 401(k) plan who claimed that the company violated its fiduciary duties by offering shares of retail class mutual funds in its plan when a similar, less expensive institutional class of shares was available.

The Ninth Circuit Court of Appeals upheld a District Court decision dismissing the plaintiffs’ claims with regard to funds that were added to the plan in 1999 because the funds were selected by the plan fiduciaries more than six years prior to the time the lawsuit was filed in 2007, and the plaintiffs did not show that a change in circumstances required the fiduciaries to undertake a review of the funds. Therefore, the District Court held and the Ninth Circuit agreed, the statute of limitations under the Employee Retirement Income Security Act of 1974, as amended (ERISA) barred the claim.

However, in a unanimous vote, the Supreme Court ruled that the claim was not time-barred because plan fiduciaries have a continuing duty “to monitor trust investments and remove imprudent ones,” and this continuing duty “exists separate and apart from the trustee’s duty to exercise prudence in selecting investments at the outset.” As a result of this continuing fiduciary duty, the Supreme Court held that the statute of limitations with respect to the plaintiffs’ claim had not expired and the case was remanded to the Ninth Circuit for reconsideration.

**A Residual of the Tibble Decision: Ambiguity**

The Supreme Court, while expanding the definition of fiduciary responsibility to include ongoing monitoring of investments, declined to address the scope of these ongoing obligations and provided no guidance on how to evaluate them, except to say that “changed circumstances” (defined as circumstances that would cause previously deemed prudent investments to become imprudent) was not the only condition under which a fiduciary’s failure to re-evaluate plan investments may violate ERISA.
Although most responsible plan fiduciaries already consider the ongoing monitoring of plan investments an integral part of their fiduciary duties, the *Tibble* case and others that are likely to be filed in the wake of this ruling will be closely watched for guidance on what the duty to monitor plan investments actually looks like in practice.

### How Often Plans Evaluate Plan Investments and Benchmark Fees

<table>
<thead>
<tr>
<th>Evaluation of Plan Investments</th>
<th>Benchmarking of fees</th>
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<tr>
<td>Monthly</td>
<td>11%</td>
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<tr>
<td></td>
<td>5%</td>
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<tr>
<td>Quarterly</td>
<td>32%</td>
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<td>17%</td>
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<td>Semi Annually</td>
<td>18%</td>
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<td>Annually</td>
<td>25%</td>
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<td>38%</td>
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<td>Every 2 years</td>
<td>6%</td>
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<td>8%</td>
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<td>Every 3-5 years</td>
<td>5%</td>
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<td>9%</td>
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<td>Unsure</td>
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*Source: Ignites Retirement Research, March 2015*

### Potential Future Implications

The possible implications of *Tibble* may be wide ranging, including:

- The frequency and depth of investment reviews may need to change. While this decision has set a precedent by affirming that there is a continuing duty under ERISA, the Court took no position on the plan fiduciary’s actual duty in this regard. These questions were remanded back to the Ninth Circuit.

- Plan sponsors who lack the time, expertise and resources to meet this higher bar of fiduciary duty may increasingly outsource investment selection and monitoring to service providers in order to transfer the fiduciary risk.

- With the clarification of the six-year rule, plan sponsors may need to retain records for a much longer period of time. They should also seek information about investment performance and fee analyses more frequently to assist in meeting this ongoing requirement.

- The trend toward lower cost funds may accelerate if plan sponsors see added liability attached to the failure to select funds with a prudent fee structure for the size of the plan. This focus on lower fees could eventually mean that top investment talent becomes less available to 401(k) participants.

- The decision may make it easier for employees to win lawsuits over excessive fees and underperforming funds.

- As cost pressures rise, providers may exit the 401(k) plan market, which could hurt smaller-sized plans through higher prices and lower quality plan offerings.

Of course, it is impossible to know what the real impact of *Tibble* will be, if any. What is more certain is that plan sponsors continue to face an ever evolving landscape, which requires attention to changes as they come, flexibility in responding to them and committed service providers to guide them through the challenges.
Framework for Plan Investment Due Diligence

Now that ongoing monitoring of plan investments is no longer just a “best practice,” but the confirmed standard of fiduciary care, plan sponsors should review their existing process for investment selection and ensure they have a well-defined process for ongoing monitoring and fund replacement.

In our opinion, a well-defined and comprehensive approach to investment selection and monitoring investments should consist of four pillars:

1. **Investment Policy Statement**
   The Investment Policy Statement (IPS) codifies policies and objectives for the plan and the measures that will be used to gauge the success in meeting stated goals.

   One important element of the IPS is the strategy and practices relative to plan investments. Prior to the selection of any investments, plan sponsors should seek to define the needs and objectives of plan participants. For instance, the age, investment sophistication, savings pattern and financial resources of the employee population may help determine the strategy for developing an investment menu for the plan.

   The IPS also outlines the process by which investments will be selected and reviewed, and the triggers that will be employed to replace them.

   The evaluation of investment managers should be on the basis of both:
   - Qualitative criteria, such as manager philosophy and process, management team and support structure, historical legal or compliance issues, risk management and organizational structure and culture; and
   - Quantitative criteria, such as performance against benchmarks and peers, risk-adjusted returns, tracking error, upside and downside capture, consistency of performance relative to its peer group universe and operating expenses.

   It’s not good enough to simply have an IPS; rather, plan fiduciaries must abide by its processes and limitations, and should retain documentation that illustrates how investment choices met and continue to meet the criteria required by the IPS.

2. **Diversification**
   Plans need to offer a diverse range of investment alternatives to serve the varied risk profiles and investment objectives of plan participants. Offering a range of investment options across stocks, bonds, and cash equivalents should allow participants to build well-diversified portfolios.

   Plan fiduciaries may consider offering target date funds across a spectrum of future retirement dates. According to the Plan Sponsor Council of America’s (PSCA) 2013 Annual Survey of Profit Sharing and 401(k) Plans, two-thirds of 401(k) plans give participants access to target date funds, which are intended to offer a simplified way to obtain a professionally managed, diversified portfolio in a single investment.

   Plan fiduciaries may also want to consider offering index funds, which can offer the advantages of lower costs, low tracking error and generally broad diversification within a specific asset class.

3. **Manageable Choice of Options**
   While choice is usually good, too much choice can lead to confusion and inaction, at the cost of smart decision-making by employees, and even their participation in the plan. The average number of investment options is 21 for best in class plans.¹

   When creating an investment menu, a streamlined approach tends to be more effective than a long list of fund options. If you have a subset of employees clamoring for additional funds, it may be worthwhile to consider adding a self-directed brokerage window feature to the plan – allowing time constrained or less savvy participants to stick with a manageable number of “core” funds, while those with greater time, interest and/or expertise can leverage the expanded window.

4. **Ongoing Monitoring**
   As shown in the *Tibble* decision, the standard of fiduciary responsibility requires ongoing monitoring of plan investments and replacing investments no longer deemed to be prudent.

   This continuing responsibility requires a comprehensive and periodic process that analyzes funds on the basis of actual performance, risk, style consistency and other significant or other noteworthy characteristics or changes, such as changes in portfolio manager or fund manager ownership. It is important that these reviews be documented and retained.
Proactive Steps for Plan Sponsors to Consider

In view of this changed landscape, plan sponsors may want to consider these steps:

1. Determine whether more frequent investment monitoring for your plan is warranted. Consider conducting and documenting a review of plan investments at least once a year. Your current plan vendor may be willing and able to assist in this process.

2. Review the plan’s Investment Policy Statement and update it, as necessary.

3. Benchmark the plan’s current fund line-up vs. what is available in the marketplace on performance, cost, and other measurable or observable criteria.

4. Document all reviews and decisions. Again, your current plan vendor may be willing and able to assist in this process.

5. Confirm that current fee disclosures are adequate under ERISA section 408(b)(2).

Stay Informed

PNC is actively monitoring the Tibble case and other developments in the retirement plan industry. Contact us today to learn how PNC Retirement Solutions can keep you informed and help you and your employees meet tomorrow’s investment and retirement goals with our defined contribution plan services:

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Source: Supreme Court of the United States blog (SCOTUS) http://www.scotusblog.com/case-files/cases/tibble-v-edison-international/