Comments on the *Tibble v. Edison* Decision: Practical Applications for Plan Sponsor Committees and Advisors

By Dr. Gregory W. Kasten and Jason Grantz

On May 18, 2015, the US Supreme Court announced an important ERISA plan decision in Tibble v. Edison International. *[135 S. Ct. 1823 (2015)] The Supreme Court held that 401(k) plan fiduciaries have a duty to prudently monitor a plan's investment options. The key issues in this case were whether retail or institutional share classes were prudent for the Edison plan, and the applicability of the statute of limitations to committee decisions.*

The original suit claimed that Edison, a California-based utility, failed to fulfill its fiduciary responsibility to employees participating in its 401(k) plan because it offered several funds using more expensive share classes among the plan's investment offerings. The plan funds had higher fees than other nearly identical funds. This case focused on whether or not the plan sponsor, and other plan fiduciaries, had a duty to continually monitor the investments in the plan.

With regards to the duty for ongoing monitoring, the Supreme Court wrote:

> An ERISA fiduciary must discharge his responsibility "with the care, skill, prudence, and diligence" that a prudent person "acting in a like capacity and familiar with such matters" would use.
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> Under trust law, a trustee has a continuing duty to monitor trust investments and remove imprudent ones. This continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset.

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It is that second part that the Supreme Court felt that the lower courts got wrong, that the duty to monitor investments represents an ongoing decision and thus is not subject to a statute of limitations. Also, interestingly, the Supreme Court did not say *what type* of monitoring should have taken place. They left that for the lower courts to decide after taking into account testimony from ERISA experts.

With regards to what *type* of monitoring should take place the Supreme Court wrote:

> This Court expresses no view on the scope of respondents' fiduciary duty in this case, e.g., whether a review of the contested mutual funds is required, and, if so, just what kind of review. A fiduciary must discharge his responsibilities "with the care, skill, prudence, and diligence" that a prudent person "acting in a like capacity and familiar with such matters" would use.

It would be a mistake to view this case in the simple lens concerning the price of a particular mutual fund share class. This case is about the duty to monitor the retirement plan from a holistic fiduciary viewpoint. So what can the industry learn concerning a prudent approach that people "acting in a like capacity and familiar with such matters" would use? Some would argue that this really is not new information; rather what the ruling does is further reinforce the critical importance of having an ongoing prudent process in a fiduciary capacity.

Amicus Curiae Brief for Fiduciary Standards

We can, however, gain practical insight on a prudent approach from an amicus curiae brief filed in this case. This is not a claim to be the only standard of care, but it does meet the definition of a "person familiar with such matters acting in a like capacity." With regards to the standards of care for ongoing monitoring, Roger Levy, the fiduciary expert, wrote in the amicus brief to the Court:

> The CEFEX [Centre for Fiduciary Excellence] certification of a qualified plan, including 401(k) plans, is based on the fiduciary standard described in the handbook Prudent Practices for Investment Stewards. For investment advisors, CEFEX bases certification on the handbook Prudent Practices for Investment Advisors. Both are by FI360 of Bridgeville, Pennsylvania, and contain 21 best practices, including supporting criteria, describing how an investment fiduciary can prudently manage the investments for which it is responsible.
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> Each practice is substantiated by ERISA, the Uniform Prudent Investor Act, the Uniform Prudent Management of Institutional Funds Act, the Uniform Management of Public Employee Retirement Systems Act and the Investment Advisors Act of 1940. (Collectively, the Prudent Practices applicable to Investment Stewards and to Investment Advisors are referred to herein as "the Practices.")

[Roger Levy and Brian Glasser, "Brief of Cambridge Fiduciary Services LLC as Amicus Curiae in Support of Petitioners, Glenn Tibble, et al., Petitioners v. Edison International, et al.," December 9, 2014]

Fiduciary Best Practices for the Plan Committee

The system referenced by Mr. Levy to the court in this case is one that prescribes a prudent process. It is a system of best practices that a committee could implement—a system that would leave a detailed history of decisions made with all of the substantiation for the decision, memorialized as part of the plan's historical record.

Within the construct of such a system also is the prudent practice of assessing oneself periodically to not only ensure that previous decision-making was prudent, but also that it continues to be prudent as time passes and prevailing thinking changes. It is within this aspect of the system that the duty to monitor is upheld. A reasonable blueprint for fiduciary best practices (21 listed best practices) for the plan committee—generally assumed to be a named plan fiduciary under ERISA Section 402(a)—is detailed under Prudent Practices for Investment Stewards. [FI360, Prudent Practices for Investment Stewards, 2013, *http://www.fi360.com/prudent-investment-process/stewards-practices*] The plan committee also is able to assess their ongoing stewardship by following the self-assessment questionnaire also available at FI360. [*http://www.fi360.com/main/pdf/SAFE_steward.pdf*]

Fiduciary Best Practice S-4.4 ("[p]eriodic reviews are conducted to ensure that investment-related fees, compensation, and expenses are fair and reasonable for the services provided.") is particularly relevant to *Tibble v. Edison*.

"Under the Circumstances then Prevailing" Standard of Care

The ERISA monitoring standard is continually evolving. This is codified in ERISA itself when it talks about "under the circumstances then prevailing." Some plan sponsors may wonder, for example, why

fund fees in the *Tibble* case seem so important today when it was not such an issue merely a decade ago. The answer is that the prudent standard of care evolves over time. What is true today may not have been true 15 years ago. Under ERISA, a fiduciary must discharge its duties with respect to a plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. [ERISA § 404(a)(1)(B)]

Consistent with this statutory language, the prudence of a fiduciary decision is evaluated with respect to the information available at the time the decision was made—and not based on facts that come to light only with the benefit of hindsight. [Bunch v. W.R. Grace & Co., 555 F.3d 1, 10 (1st Cir. 2009)]

Plan fiduciaries must consider those facts and circumstances that are relevant to the monitoring of prudent investment options. The first step is to determine the information needed to make an informed decision. A fiduciary must have the expertise to make this determination, and in the absence of such expertise, seek it out. This is what a "prudent man acting in a like capacity" would do.

This requirement is not limited to what the fiduciary knows, but extends to what he or she *should know.* This means the fiduciaries need to have the same information that would be used by a person who is knowledgeable about the particular issue. The reality is that it is highly unlikely that most individuals serving on the retirement plan committee—which generally are in-house employees of the plan sponsor—would be able to keep up with the changing environment of investment monitoring. They have a duty to retain prudent experts to help them with these matters.

The plan committee, however, must always remember that, as a named plan fiduciary, they are ultimately in charge. "From the perspective of ERISA fiduciary liability, the role of the named fiduciary is unique. Under the general definition of a fiduciary [ERISA Section 3(21)(A)], a person's potential fiduciary liability is limited 'to the extent' the person performs fiduciary functions. The extent of liability under ERISA for a named fiduciary, however, is distinctly different. Under ERISA [ERISA Section 402(a)], the default rule is that the plan's named fiduciary is liable for the entire operation and administration of the ERISA plan." [Weiler, John, "Fiduciary Provisions of the Employee Retirement Income Security Act of 1974," *Louisiana Law Review*, Vol. 36, No. 4, Summer 1976]

Indeed, in the Court's decision regarding *Tibble*, the judge wrote:

> We offer this background to illustrate a point, which, though it should be unmistakable, seems to have eluded Edison in its briefing. HFS is its consultant, not the fiduciary. "As Judge Friendly has explained, independent expert advice is not a 'whitewash.'" Just as fiduciaries cannot blindly rely on counsel, Donovan v. Mazzola, 716 F.2d 1226, 1234 (9th Cir. 1983), or on credit rating agencies, Bussian, 223 F.3d at 301, a firm in Edison's position cannot reflexively and uncritically adopt investment recommendations.

[Tibble v. Edison Int'l, No. 10-56406 (9th Cir. 2013]

In terms of 401(k)-type plans, like *Tibble*, the fiduciaries need to have an understanding of the investments and services that are currently available in the marketplace for participant-directed plans. This field changes rapidly, and what was "state of the art" a few years ago may be out of date today. For example, a decade ago, who could have foreseen that target date funds would become the preponderant way many, if not most, participants would invest their account balances?

It would be a mistake to jump to the simplistic conclusion that institutional shares are required in every plan. In some cases higher revenue used for specific plan services such as individual meetings with employees to improve their outcomes could be considered prudent. This cost/benefit concept is consistent with what the DOL has outlined in their publication, "Meeting Your Fiduciary Responsibilities."

> Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments. When the fees for services are paid out of plan assets, fiduciaries will want to understand the fees and expenses charged and the services provided. While the law does not specify a permissible level of fees, it does require that fees charged to a plan be "reasonable." After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable. [*http://www.dol.gov/ebsa/pdf/meetingyourfiduciaryresponsibilities.pdf*]

Likewise, it would be a mistake to believe ERISA requires some kind of clairvoyant futuristic stock market prediction or mutual fund outperformance selection capability which, of course, does not exist.

Rather, the best way to think about it is if there was a room with 100 ERISA experts, the fiduciaries should be doing what at least 51 out of 100 experts would be doing. Thus ERISA prudent process requires both procedural prudence and substantive prudence. Procedural prudence was alleged to be lacking in *Tibble* because the committee never even debated (or documented) whether to use a less expensive share class.

The DOL stated in their amicus curiae brief:

> Although the Investment Committees took those steps to monitor plan investments, they failed to consider a key question, which was whether the mutual funds at issue were available as lower-cost institutional class funds. Although "the fund's total expense ratio" was one of the Plan's investment criteria, J.A. 145, 151, 176, 230, and those criteria "were expected to be applied periodically in monitoring of the plan investments," J.A. 183; see J.A. 124, 155-156, 169, respondents never "even considered or evaluated the different share classes" of the mutual funds at issue. [Roger Levy and Brian Glasser, above]

The main practical takeaway from this case for retirement plan committees is the absolute need for a prudent process that is both procedural in nature (written, followed, documented, checked) and substantive in content. This is not new information; many professional discretionary corporate trustees, fiduciary advisors, and ERISA experts already espouse this idea and have for many years. Nonetheless, it is the primary important lesson taught by this case.

Fiduciary Best Practices for the Plan Advisor

Importantly, *Tibble* provides ammunition for the plan advisor, investment manager, or discretionary trustee who, acting as a fiduciary, can continue to add value with their clients by helping them implement, monitor, and document a prudent process. In the future, this will become critically important with most advisors becoming fiduciaries under the DOL's fiduciary proposal [US Department of Labor released its re-proposed rule "Definition of the Term 'Fiduciary'; Conflict of Interest Rule—Investment Advice" on April 20, 2015, available at *http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28201*]

As discussed previously in this article, fiduciaries have an ongoing duty to monitor at a prudent expert standard of care. Prospectively, it will be much more important to keep documentation to *prove* that you were prudent using nationally recognized best-in-class standards, rather than to just say you were prudent. Using the marketing phrase "co-fiduciary" or typing "fiduciary" on your business card will not count for much. What will matter is having a documented prudent process 100 percent of the time. Newly-minted fiduciaries may be at a loss to deliver a well-documented prudent process in any kind of scalable, profitable business model. This is made more difficult in the face of ever greater pressures to reduce fees as the entire industry undergoes fee compression. This combination of market driven forces, the Supreme Court's decision, and new laws will cause the need for a uniform set of best-in-class standards to be the bare minimum when providing fiduciary services to retirement plans.

Conclusion

For both the investment advisor coming under the DOL's universal fiduciary standard, and the plan committee or discretionary trustee as a named plan fiduciary, the duties and risks have never been greater. Fortunately there is an emerging standard of care that allows both procedural and substantive prudence to be put in place by the plan committee and the servicing fiduciary advisor and/or discretionary trustee.

A more complex decision creates a greater need for monitoring. Monitoring is applicable to not just investments, but all decisions the fiduciary makes that have ongoing consequences, for example, hiring a TPA, and so on. The *Tibble* case really tells us that plan fiduciaries must have a prudent process in place that is always focused on the best interest of plan participants. It is only what is in the best interest of plan participants that matters. Likewise, it is vitally important for fiduciaries to keep detailed minutes of how decisions were made. It should be possible to re-create the decision making process years later by reviewing the minutes. Without documentation you might as well assume the process never happened.

Responsible plan fiduciaries must engage in an objective, thorough, and analytical search; avoid self-dealing and conflicts of interest; consider the risk associated with the investment versus alternatives; consider all costs in relationship to services provided; and focus on improving outcomes. They must document their actions and ensure the investments are diversified to minimize the risk of large losses. Finally, they must consult with experts when that expertise is lacking, and always periodically monitor previously made decisions. The Supreme Court's *Tibble v. Edison* decision really does not tell us anything new. It simply reinforces what we should already be doing. ■