Excessive-fee lawsuit to result in major changes

Now before high court, case will affect plans no matter the outcome

By Darla Mercado

Oral arguments in a pivotal 401(k) lawsuit before the Supreme Court were heard last Tuesday, and regardless of the outcome, advisers can expect changes to the way they do business.

Tibbile v. Edison International, filed in 2007 by plan participants against their employer, paved the way for litigation against plan sponsors for having overly costly funds within a 401(k) plan.

The lawsuit centers on the plaintiffs' claim that six of the funds in Edison's retirement plan were retail share class funds, despite the availability of cheaper institutional share classes.

In 2010, the U.S. District Court for the Central District of California granted a judgment of $370,732 in damages related to excessive fees in three of the retail share class funds. Litigation over the remaining three funds moved to the 9th U.S. Circuit Court of Appeals and then the Supreme Court.

The defendants claimed a statute of limitations required the plaintiffs to file suit alleging a fiduciary breach within six years of the last action constituting the breach.

The appeal before the Supreme Court centers on two questions.

The one legal experts stress is whether the six-year statute of limitations on fiduciary violations protects retirement plan fiduciaries that maintain investments that continue to cause losses if the funds were added over six years earlier.

But surprisingly, both parties in this suit agree that fiduciaries have an ongoing duty to ensure that investments are prudently managed. The plaintiffs say that you have to go back and monitor if there is a significant change to a fund, said Fred Reish, a partner at Einhorn, Biddle & Reish. "The plaintiffs say that every year there's a new duty to monitor. Essentially, that's the fight."

In a practical sense, the case serves to remind advisers and plan fiduciaries that they can't simply select funds and then forget them.

"Fiduciaries need to monitor and look at the investments each year to see if there are changes and if they are appropriate for the plan," Mr. Reish said.

That review should include grandfathered options that predate the fiduciary now overseeing the plan.

'OLD AND COLD'

"If something is old and cold in the lineup and you haven't looked at it in a while, is it prudent? Is it best practices if we have this [fund] and it's grandfathered?" asked Marcia Wagner, managing director at the Wagner Law Group.

The second question involved in Tibbile is whether the statute of limitations applies in cases in which a plan fiduciary breached the duty of prudence by offering higher-cost retail class mutual funds in a plan when identical institutional class investments were available.

How the Supreme Court addresses retail versus institutional share classes is especially important to small retirement plans and the advisers serving them. Those plans generally don't have the assets needed to buy institutional share classes, and vendors are interested in working with that part of the market because of the 12b-1 fees and other expenses related to retail funds, Ms. Wagner said.

Mutual funds with revenue sharing often help subsidize the administrative costs of smaller plans, and fiduciaries need to consider that when choosing funds.

dmercano@investmentnews.com
Twitter: darla_mercado