InvestmentNews
The Leading Information Source for Financial Advisers

Key 401(k) Supreme Court suit will shake up retirement plan advisers

Expect more due diligence on funds and fees, and expect to do it more frequently

By Darla Mercado | *December 22, 2014 - 4:23 pm EST*

As 2014 winds down, retirement plan experts are eyeing a key U.S. Supreme Court case that could shake up the way financial advisers work with their retirement plan clients.

The case in question is the famed Glenn Tibble v. Edison International suit, which was filed in 2007 and was a pioneer among lawsuits brought by employees against their employers for excessive 401(k) fees.

A key issue in the case is that Edison gave its plan participants about 40 mutual funds to choose from within the 401(k) menu. Six of those funds were retail share class funds, even though cheaper institutional share class versions were available.

In 2010, a judgment in the U.S. District Court for the Central District of

California granted the plaintiffs $370,732 in damages related to excessive fees in three of the retail funds. However, the litigation has continued since then, reaching first the 9th U.S. Circuit Court of Appeals and then the Supreme Court.

Over the course of December, interested parties flooded the Supreme Court with amicus briefs in support of Mr. Tibble and the other plaintiffs. Most notably, submissions came from Donald B. Verrilli Jr., a U.S. Solicitor General, a panel of law professors and seniors advocacy group AARP.

It'll be some time before the Supreme Court comes up with a decision, but the amicus briefs highlighted the fact that fiduciaries — namely 401(k) advisers and plan sponsors — will need to refine their due diligence processes around fund and service provider selection.

It won't be enough to just go all-index in 401(k) investment menus; advisers will have to delve into the differences between share classes and seek details on revenue sharing arrangements.

"There will be more focus on what the provider and the adviser are getting from revenue sharing," said C. Frederick Reish, partner at Drinker Biddle and Reath. "If it's included in the expense ratio, it's a 12b-1 fee. In a group variable annuity, it's a commission."

As a result, Mr. Reish expects two different types of advisers to emerge in the retirement plan space. One might decide to avoid funds and record keepers that use revenue sharing arrangements. In that case, the plan will directly pay the record keeper and the adviser.

In the second scenario, the adviser might lean toward funds that allocate

revenue share back to the participants, according to Mr. Reish.

Advisers need to analyze the details of these arrangements. For instance, a retail mutual fund with an expense ratio of 60 basis points and a revenue sharing rebate of 25 basis points will only cost participants 35 basis points. The institutional share class of that fund, however, could have the same expense ratio but no revenue sharing and thus would be more costly.

Expect to do more homework on the different share classes available, too. Large plans tend to have broader access to institutional share classes or I-shares, as well as R-shares, which are intended for retirement plans and can bundle in recordkeeping and other fees. That level of due diligence will be more complex for small plans that use group variable annuities, which are considered separate account products.

"You may find a group variable annuity has 10 to 15 separate account classes and what separates one from the other is the amount of compensation paid to the adviser and to the provider," Mr. Reish said.

Advisers and 401(k) investment committees will also need to take additional steps to protect themselves from fiduciary liability in light of the Tibble case. In a brief filed this summer, Mr. Verilli declared that "plan fiduciaries have a 'continuing fiduciary duty' to review plan documents and eliminate imprudent ones." The defendants in the Tibble case had contested that the plaintiffs were subject to a statute of limitations that required them to file a suit alleging fiduciary breach within six years of the last action constituting the breach.

The best practice, particularly in light of the Tibble case, is an additional layer of review.

"I would say there's an additional component, be it annual or periodic, where the plan fiduciaries go back and look at their investment policies, reevaluate how did they come up with them and are they still appropriate, are breakpoints available," said Jason C. Roberts, CEO of the Pension Resource Institute.

That topic goes beyond the range of a typical quarterly review of the investment menu, he added.

Mr. Roberts noted that advisers are safeguarding themselves by carving out potential legacy decisions when they draw up contracts with plan sponsors. "We see some advisers saying 'I want an express acknowledgement from the plan fiduciary that I'm not responsible for anything that's been decided before I got here,'" he said.

For example, an adviser might have oversight in determining which funds go into the 401(k) menu, but he might have nothing to do with the stable value fund that had already been chosen before he started working with the plan. It's better to draw a line to determine that fiduciary boundary.

Regardless of how the case shakes out, Mr. Reish expects that the additional due diligence measures will tilt the 401(k) market even more in favor of retirement specialist advisers.

"The problem is that most fiduciaries aren't that sophisticated and the burden will fall on the adviser to help them understand it and do the right job," he said. "It seems to me that with this increasing complexity, it favors advisers specializing in plans."