Fiduciary Obligation to Select Appropriate Share Classes

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I imagine that, by now, you have heard about the Court of Appeals decision in Tibble v. Edison. While the court decided a number of issues, the most important one is that fiduciaries have an obligation to select appropriate share classes for their plans. Closely related to that is the trial court's admonition that fiduciaries must ask about the available share classes.

ERISA imposes both a fiduciary rule and a prohibition on spending more than reasonable amounts for operating a plan, including the investment costs. The Tibble decision was about the reasonable expense ratios for plan investments. However, rather than looking at the evaluation of mutual fund expenses in the traditional way (that is, comparing expense ratios to those of other funds), the trial court found, and the appellate court agreed, that plans must use their purchasing power to select the appropriate share class. The practical consequence is that advisers should make recommendations based on the share classes available and must

educate plan sponsors about the available share classes, including their costs, and plan sponsors (typically acting through their plan committees) must understand that multiple share classes may be available and must investigate which are best for their plan and participants.

That could be a daunting task. Just consider that some mutual funds may have 10 or more share classes. That could include, for example, A, B, C, I, R-1, R-2 shares, and so on. This will place an additional burden on advisers . . . and, in that sense, may favor advisers who focus on retirement plans.

But, it is more complicated than that. Share classes for mutual funds and separate account "classes" for group annuity contracts may, for these purposes, be virtually identical. If that is true, advisers will need to educate plan sponsors on the classes available in group annuity contracts. Then, advisers will need to help plan sponsors select the appropriate separate account class for that particular plan. Since some insurance companies offer group annuity contracts with 10 or even 15 separate account classes, advisers will need to be more attentive to the alternatives that are available and will need to work with plan sponsors to understand the share and separate account classes (including the revenue sharing and compensation aspects) and to select the appropriate classes based on the size and needs of the particular plan.

In the future, we could see litigation where advisers did not educate plan sponsors on the availability of alternative classes and do not make appropriate recommendations.