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Legal Compliance

Who’s Minding the 401(k)? Tibble v. Edison Points to Employer's Duty

The Supreme Court ruling expands the rights of employees to sue their employers for failing to be diligent in the monitoring of their retirement plans.

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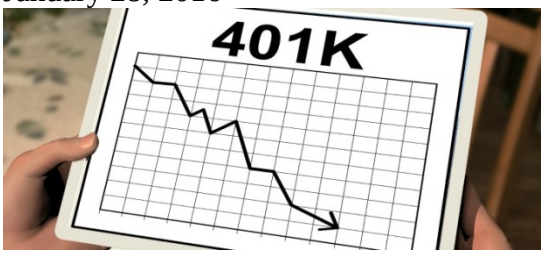

In last year’s *Tibble v. Edison International* 401(k) case, the U.S. Supreme Court ruled that plan sponsors — the employers — have an ongoing duty to monitor the investments in their 401(k) plans and act prudently to eliminate investment options that are not in the best interests of the employees or plan participants.

The court’s decision expands the rights of employees to sue their employers for failing to be diligent in the monitoring of their 401(k) plans. As more than one industry observer has said, the Supreme Court’s decision in *Tibble v. Edison International* should be a major wake-up call for all plan sponsors.

A recent panel discussion on the ramifications of the decision included Charles Massimo, CEO of CJM Wealth Management; Nichelle Langone, supervisory investigator with the U.S. Labor Department’s Employee Benefits Security Administration; Donna Massanova, partner, employee benefit plans, at Certified Public Accountant firm Baker Tilly Virchow Krause; and Katherine Heptig, counsel in the corporate department of the law firm of Farrell Fritz.

According to Massimo, “401(k)s are a huge profit center for Wall Street, which has never had to justify its fees. While, the Department of Labor’s fee disclosure rule of July 16, 2011, was an important first step in the right direction toward fee disclosure and transparency, the court’s decision now makes it very clear to plan sponsors that they have an ongoing duty of prudence to

monitor these plans or else face the risk of liability that can stretch beyond the six-year statute of limitations."

Massanova, whose role as an auditor is to review the processes and internal controls in place for monitoring these plans as well as the selection of third-party service providers and the fee structure, said, "The monitoring of the investment in *Tibble v. Edison* was blatantly lacking."

Heptig added that, "In *Tibble v. Edison*, the ruling was that there is an ongoing duty to monitor. The attorneys for Edison argued that there has to be a major change to require the sponsor's review and monitoring and, while the district court and appeals court had previously agreed with this argument, the Supreme Court sided with Tibble, the plaintiff."

Looking at Losses

To illustrate the importance of plan sponsors' ongoing monitoring became clear when Massimo demonstrated just how significant different decisions, from the investment share class to the associated expense ratios, can affect a retirement plan. His example showed how a difference between a 401(k) account earning 8 percent vs. 6 percent over 40 years for a plan participant who invested $5,000 per year would represent a loss of $578,667, or $28,933 per year, for the retiree.

"In 90 percent of the cases, there is a complaint from an employee on which we at the DOL must act," Langone said. "In other cases, our EFAST2 system pulls up red flags such as delinquent distributions, dishonest behavior or no bonding. We also have access to BrightScope (an independent provider of retirement plan ratings and analytics).

"When we review plans, we want to make sure the compliance is there and that the people responsible are aware of their fiduciary responsibility and making decisions that are in the best interests of the plan participants."

In discussing who is a fiduciary, Langone said that, under the Employee Retirement Income Security Act of 1974, or ERISA, the named fiduciary is supposed to be noted in the plan documents, although sometimes they are not.

She explained that ERISA defines fiduciaries as plan sponsors and decision-makers. Because many company owners don't know enough about 4  01(k) plans, they delegate the responsibility to a service provider, but the primary fiduciary still has a responsibility and ongoing duty to monitor their plan's service providers and investments.

Massimo pointed out that a nonfiduciary involved in a plan is only required to make sure a plan's investments are "suitable," while a fiduciary has a responsibility to act in the best interest of the plan participants. He added that investment houses cannot be fiduciaries, but when you hire a third party, it's contractual. Heptig added that, "Even the act of delegating is subject to a fiduciary responsibility. The selection of a fiduciary must also be prudent."

Massanova made an important point regarding fiduciaries. "If you are a fiduciary, your personal assets are at risk," she said. "You must document everything you do, from your processes to how you pick your service providers. Even regulators will ask about internal processes. If they feel you do have good processes, they will not expand their investigation. For smaller companies, it's always prudent to have an independent audit, ideally on a three-year cycle."

Massimo advised that everyone should have a fiduciary manual containing everything they do and all of a plan's documentation.

"Transparency is important," he said. "You want to know who's doing what, what fees are being paid and to whom."

Langone added that, "Under the 408(b)2 regulations, fiduciaries must disclose fees, and the fees must be reasonable. They also have a responsibility to disclose plan fees to participants as well as the investments and associated risks."

Massimo explained how BrightScope provides third-party scores for plans, benchmarking them against peer plans so sponsors can see how their plans compare. He said that fiduciaries should ask for their plans' FI360 score.

The panel concluded that there is a continuing interest in fallout from the court's decision and the increase in employee lawsuits against employers for failing to meet their fiduciary responsibilities as in *Tibble v. Edison International*.

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