Advisers should heed fiduciary principles in ongoing Tibble 401(k) suit

Developments in the excessive-fee lawsuit highlight the duty to monitor investments and the duty of a prudent trustee to be cost-conscious

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By **Marcia S. Wagner**

At the end of last year, Glenn Tibble's **long-standing claim against Edison International** regarding excessive 401(k) fees was **given an opportunity to continue** by the U.S. Circuit Court of Appeals for the Ninth Circuit.

The primary issue in that case (the first regarding excessive 401(k) fees to be heard by the Supreme Court) was a procedural one, but the court also discussed two substantive areas of law under the Employee Retirement Income Security Act of 1974 that's of interest to investment advisers: the duty to monitor and the duty of a prudent trustee to be cost-conscious.

With respect to the duty to monitor, which the Supreme Court had asked the Ninth Circuit to address in this case, the appellate court turned to traditional trust law, which provides

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that a trustee has a continuing duty to monitor trust investments and remove imprudent ones.

This duty is separate and apart from the duty to exercise prudence in selecting investments at the outset. According to the appellate court, quoting the Supreme Court's opinion in Tibble v. Edison, a trustee must "systematic[ally] conside[r] all the investments of the trust at regular intervals to ensure that they are appropriate." The trustee is held to a "prudent investor standard," requiring the fiduciary to "exercise reasonable care, skill, and caution," and "reevaluate the trust's investments periodically as conditions change."

Thus, the court declined to provide any specifics as to the duty to monitor — the frequency of review is not addressed, nor are

potential setback to plaintiffs using Vanguard as fee benchmark

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There is also some ambiguity in stating that reevaluation is required as conditions change, although the Ninth Circuit opinion made clear that a significant change in circumstances is not required.

Hopefully, future cases will provide more concrete guidance as to what the duty to monitor specifically entails.

The Ninth Circuit, quoting sections 90 and 88 of the Restatement (Third) of the Law of Trusts, which seeks to organize and explain trust-law principles, then explained that a "trustee is to incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship." Further, "cost-conscious management is fundamental to prudence in the investment function," and should be applied "not only in making investments but in monitoring and reviewing investments. … Implicit in a trustee's fiduciary duties is a duty to be cost-conscious."

The Ninth Circuit concluded with a statement from the Uniform Prudent Investor Act: "Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs."

Thus, even low-cost funds such as a **Vanguard Group** fund that charges 0.04% can be challenged, **as it was in Bell v. Anthem**, as a breach of fiduciary duty, because there was an identical Vanguard fund that charged only 0.02%. Applying the same rationale, fiduciaries will be asked if they have considered collective investment trusts as an alternative to mutual funds.

Also, other language from section 90 of the Restatement of Trusts referenced by the Ninth Circuit, but not relevant with respect to the claim in Tibble v. Edison, will likely be cited in cases holding that the absence of an index fund is a breach of fiduciary duty: "The duty to avoid unwarranted costs is given increased emphasis in the prudent investor rule. This is done to reflect the importance of market-efficiency concepts and differences in the degrees of efficiency and inefficiency in various markets. … In addition, active market strategies involve investigation expenses and other transaction costs … that must be considered realistically in relation to the likelihood of increased return from such strategies."

To place this in context, the same arguments in favor of index funds were advanced 40 years ago, and courts have, to date, not been receptive to such arguments. However, while cost-containment is applicable to the duty to monitor, it is equally applicable to the initial prudent selection process, and the Ninth Circuit's reliance on these particular Restatement of Trust principles might have opened the door to plaintiffs advancing this position in future fiduciary-breach cases.

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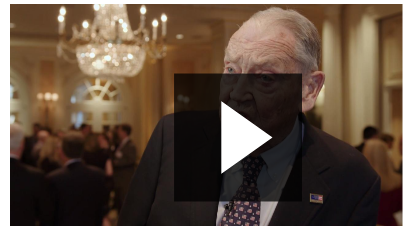

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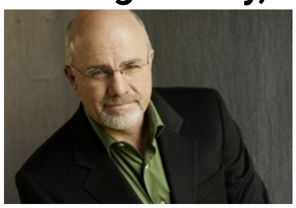

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