Client Alert

May 28, 2015

Employee Benefits and Executive Compensation Group

David R. Levin
(202) 230-5181

Joseph C. Faucher
(310) 203-4052

Adrienne L. Robertson
(215) 988-3304

Tibble and the Fiduciary Duty to Monitor (or The Only Foolish Question is the One You Didn't Ask)

The U.S. Supreme Court's recent unanimous decision in *Tibble v. Edison International* sounds a reminder that fiduciary responsibility includes the duty to monitor. *Tibble* involved a challenge by 401(k) plan participants to the retention of higher priced retail class mutual funds when allegedly materially identical lower priced institutional class mutual funds were available. The Supreme Court, stressing that all of the parties were in agreement "that the duty of prudence involves a continuing duty to monitor," found that the appellate court had failed to consider the duty to monitor, and reversed and remanded for further consideration by the appellate court.

The Supreme Court expressed no view on the scope of the fiduciaries' duty in the case under review, or on what fiduciaries in general must do to satisfy their duty to monitor. The Supreme Court even acknowledged that, when the appellate court considers the issue, it may well conclude the plan's fiduciaries "did indeed conduct the sort of review that a prudent fiduciary would have conducted."

Fund selection without ongoing monitoring ("set it and forget it") has never been a recipe for fiduciary prudence. As an ERISA fiduciary, you know that there is a duty to monitor. You also know that there is no safe harbor rule about how often to monitor, because the obligation to monitor arises in so many different factual contexts. Just for starters, fiduciaries must monitor investment managers, record keepers and other service providers, as well as all of the varied investments their plans may offer, such as employer stock funds and mutual funds.

Prudent fiduciaries would never pick a service provider and then pay no attention to the provider's performance. Monitoring gives the fiduciary insight into whether retaining the provider is reasonable and whether the fees paid for services are reasonable. So, too, monitoring an employer stock fund requires a fiduciary to consider

the business and business practices of the employer. Similarly, a fiduciary who selects an investment offering for a self-directed plan must monitor the investment offering to determine whether it continues to be appropriate for the plan and its participants, given their specific objectives.

Monitoring requires different types of questions, depending on what is being monitored. Figuring out what questions to ask is not a "by rote" process. Rather, fiduciaries can learn from their advisors and from the mistakes of others what questions to ask. The Supreme Court's ruling in *Tibble* reminds us that a fiduciary's fulfillment of the duty to monitor depends on the specific facts and circumstances of each case.

The Role of the Fiduciary is Active, Not Passive

For more than 30 years, the courts have emphasized that to satisfy fiduciary duties under ERISA, "a pure heart and an empty head are not good enough." *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983). Although ERISA does not demand that fiduciaries necessarily be experts, fiduciaries are required to be inquiring, not mute; attentive, not somnambulant; active, not passive. Reliance on experts usually cannot be a complete defense to a charge of imprudence.

Fiduciaries are expected to ask appropriate questions and get reasonable answers to those questions. ERISA fiduciaries have a duty to conduct their own independent investigation of the plan's investments, even where experts have been consulted. The judiciary has consistently ruled that a fiduciary has some duty to monitor the activities of other fiduciaries. The failure to use prudence in appointing a fiduciary and the failure to monitor the fiduciary's performance of his duties exposes the appointing fiduciary to liability. Acquiescence does not constitute an adequate monitoring system.

Minimizing Risk—Monitoring is Part of Procedural Prudence

What can a fiduciary do to minimize the risk of breaching his or her fiduciary duties? Remember that the only foolish question is the one not asked. Remember, too, that proving what was done and by whom is easier if you maintain a contemporaneous written record. Ask for written reports and signed opinion letters. Read them and, if you don't understand them, ask for an explanation. Don't be embarrassed about not understanding -- you hired professionals to help you understand. If you don't ask questions, you are potentially shortchanging the plan and exposing yourself to unnecessary risk.

For example, take a straightforward approach to the investment of plan assets. If your plan doesn't have investment guidelines, how can you demonstrate the prudence of the plan's investments? The answer is you can demonstrate it only with considerable difficulty. And, if you don't understand your plan's investment guidelines, how can you monitor compliance with those guidelines?

There are few litigated cases involving fiduciaries who had written investment guidelines, who understood those guidelines, who

monitored those guidelines, and who then purposely violated them. Most fiduciary breach cases are about imprudence, not about willful wrongdoing. You will find even fewer, if any, cases about fiduciaries who had written investment guidelines, who understood those guidelines, followed them, and monitored their investments and service providers accordingly.

Do you have guidelines for monitoring? In your agreements with service providers, do you have the right to audit to assure yourself that the service provider is fulfilling its duty under the contract? Do you exercise that right to audit? Do you have written guidelines for how often to monitor, and some record (minutes of a meeting of the plan's fiduciary committee, for example) as to why you picked the number of times to audit over the duration of the contract?

If you have an investment manager, the manager likely has a "watch list" for investments. In other words, the manager is monitoring the investments. Have you discussed that monitoring process with the manager? That discussion may help you monitor the investment manager and may help you determine guidelines for monitoring the investment options you offer participants in your 401(k) plan. Similarly, keeping a watchful eye on the court filings already made and those to be made in *Tibble* may help inform your selection of monitoring guidelines for investment offerings.

While *Tibble* doesn't tell us exactly how fiduciaries must go about satisfying their duty to monitor, we do know that effective monitoring should include questions about retail class and institutional class shares—their availability, features, and the reasons why the fees are different. For example, lower fees may be a function of limitations on the ability to trade. If fiduciaries obtain such detailed information, and document why they select or retain retail class shares when lower priced share classes are available, it can make all the difference if their decision is later challenged in litigation.

What do you call a fiduciary who never asks questions? A defendant. And, like the purple cow, we would all rather see one than be one.

Conclusion

The Supreme Court's ruling in the *Tibble* case serves as a reminder that fiduciaries have an ongoing duty to monitor. Just as there is no ERISA section that requires fiduciaries to have investment guidelines, there is no ERISA section that requires fiduciaries to have monitoring guidelines. However, written guidelines—along with a written basis for the selected guidelines—provide a measure for a fiduciary's conduct. Someone is going to write those guidelines. Should you write them? Or should you leave that task to some plaintiffs' attorney or court?

If we can help you frame the questions to ask or help you answer those questions, please let us know.