PIERCE FINANCIAL

Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

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Tibble v. Edison International

In May, the Supreme Court of the United States (the "Supreme Court") published its long-awaited opinion in Tibble v. Edison International. The Supreme Court held that an ERISA fiduciary has a duty to continuously monitor the prudence of investment options offered under a qualified retirement plan, separate and distinct from their duty to prudently initially select investment options. While the Supreme Court's brief opinion clearly dictates a fiduciary's responsibility under ERISA to review investment options on a continuing basis, it did not express an opinion on the scope of such a review.

The Participants' Claim
Participants in the Edison 401(k) Savings Plan (the "Plan") brought a class-action lawsuit against the fiduciary of the Plan claiming a breach of ERISA's duty of prudence related to the inclusion of six mutual funds in the Plan's investment option lineup. All six mutual funds were higher-cost, retail class shares. The participants claimed that institutional share classes (lower fees) of the same six mutual funds were available for inclusion in the Plan. Three of the contested mutual funds were added to the Plan's investment lineup in 1999 and three were added in 2002.

Lower Court Decisions
The District Court found that with respect to the three funds added in 2002 there was no evidence to indicate that the Plan's fiduciary had considered the availability of lower-cost, identical mutual funds, and held that in failing to do so, the fiduciary breached its duty of prudence. However, with respect to the three mutual funds added in 1999, the District Court ruled that the participants' claim was barred by ERISA's 6-year statute of limitations that began running at the time funds were added to the plan in 1999. The District Court found that there were no changed circumstances that would have required the fiduciaries to reevaluate the appropriateness of offering the contested funds in the lineup, thereby restarting the statute of limitations. The participants appealed the District Court decision, and the Ninth Circuit Court of Appeals affirmed. The participants petitioned the Supreme Court for review, and the review was granted.

Supreme Court Decision
The issue before the Supreme Court was whether the retention of an allegedly imprudent investment is an action or omission that triggers the 6-year statute of limitations. The Supreme Court found that said retention would be a new trigger, and that the Ninth Circuit erred in failing to apply trust law in determining the nature of the Plan's fiduciaries' obligation under ERISA.

ERISA requires plan fiduciaries to act with the "care, skill, prudence and diligence" that a prudent person acting in a like capacity and familiar with such matters would use in similar circumstances. The Supreme Court noted that because ERISA is derived from trust law, it often looks to trust law to determine the contours of ERISA's fiduciary duties. Under trust law, a trustee has a separate and distinct continuing duty to monitor investments and to remove imprudent ones. As a result, a plaintiff may allege a fiduciary breached its duty of prudence by failing to properly monitor investments and remove imprudent ones. A timely suit can be brought within six years of this failure.

The Supreme Court offered no guidance as to scope of the responsibility to continuously review investments. Instead, the case was remanded to the Ninth Circuit to determine what level of review is necessary and whether or not the Plan fiduciaries fulfilled their duties.

COMMENTARY: *For plan fiduciaries the Supreme Court's decision brings an end to any illusion that ongoing monitoring of plan investments may not be required. We believe the Supreme Court's decision was foreseeable and reasonable, as even minor changes to fact patterns may have sizable impacts on retirement plans and* *participants' abilities to save for retirement given their long-term purported goals.*

The good news for fiduciaries engaging Pierce Financial is that they have been proactively meeting these fiduciary responsibilities with the periodic Fiduciary Investment Reviews™ and the B3 Provider Benchmarking and Analysis™. The Supreme Court's decision in Tibble neither creates any new responsibilities for fiduciaries, nor does it heighten the existing standard of care dictated under ERISA. Rather, it is confirmation of widely recognized legal thought that fiduciaries have ongoing responsibilities, and that those fiduciaries who meet regularly, follow process, and make prudent (and well-documented) decisions should find it easy to meet, and evidence the fact that they've met, those ongoing responsibilities.

How Loans and Hardship Withdrawals Affect Retirement Savings

Recent studies indicate that the retirement plan loan policy is economically meaningful in shaping participant borrowing. The "Borrowing From the Future: 401(k) Plan Loans and Loan Defaults" study published by the National Bureau for Economic Research (NBER) concludes that for plans that allow more than one loan, the probability of plan borrowing nearly doubles.

"Borrowing from the Future" was conducted by researchers representing the Peking University HSBC Business School, University of Pennsylvania Wharton School, and Vanguard Center for Retirement Research in Malvern, Pennsylvania. The researchers tracked administrative data encompassing hundreds of plans over a five-year time period and found that 20 percent of retirement plan participants borrow at any given time, almost 40 percent do at some point over five years, and loan default "leakage" is estimated at approximately $6 billion annually across the nation.

The study shows that when a plan sponsor permits multiple loans rather than only one, the probability of plan borrowing nearly doubles, and the aggregate amount borrowed rises by 16 percent. This suggests that easier loan access encourages employees to borrow.

The study also found that 10 percent of participants who borrow from their retirement and 86 percent of employees who leave their jobs with an outstanding plan loan default on loan repayment.

The researchers conclude that limiting the number of loans to just one would likely reduce the incidence of borrowing and the percentage of total retirement assets borrowed, also reducing the impact of future defaults. Additionally, loan defaults can also impact fiduciary liability, when not properly administered.

We have noticed a significant increase in plan sponsor interest in restricting, and even removing loans from their plan as the issue of retirement savings leakage becomes better recognized.

Exchange Traded Funds in Retirement Plans

Over the last several years exchange traded funds (or ETFs) have become very popular among investors because of their lack of a minimum investment, their low cost of ownership and their ability to be intra-day traded. Most ETFs track an index such as the S&P 500, but unlike an index mutual fund, ETFs can be bought and sold just like a stock. That means that they can be bought or sold at any time during normal trading hours while mutual funds trade just once a day, at the end of a trading session.

While retail investors enjoy the trading flexibility of ETFs, retirement investors do not receive this same advantage. Participant trades within a retirement plan must be executed at the same time to avoid discrimination. As such, intra-day trading flexibility is lost within a retirement plan.

An attractive benefit of ETFs is their low cost. Most ETFs are passively managed and therefore, relative to actively managed mutual funds, they appear inexpensive. However, when compared to similar passively managed mutual funds, the cost difference between the two is negligible.

Another drawback of ETFs in a retirement plan is that they do not contain the ability to revenue share to help offset plan recordkeeping costs. In a mutual fund, recordkeeping costs can be built into the fund to help pay plan expenses. If a retirement plan was to offer ETFs, it would have to find an alternative method if there was a need to offset plan expenses.

ETFs have gained notoriety over the last several years for their low cost and ability to trade intra-day however they are far less common and less advantageous in retirement plans because the benefits are diluted in the defined contribution world.

What is a Prohibited Transaction?

As a fiduciary, you have probably heard a lot about prohibited transactions and know you need to avoid them, but seldom do we see a good definition about what they really are. Consider the following a “working” definition: A prohibited transaction occurs if a plan fiduciary engages in a plan-related transaction that the fiduciary knows (or should know) constitutes a direct or indirect:

1. Sale, exchange, or lease of any property between the plan and a party in interest;
2. Loan or other extension of credit between the plan and a party in interest;
3. Furnishing of goods, services, or facilities between the plan and a party in interest;
4. Transfer of plan assets to a party in interest or the use of plan assets by or for the benefit of a party in interest; or
5. Acquisition of employer securities or employer real estate property in excess of the limits set by law.

In addition, ERISA prohibits a fiduciary from dealing with plan assets in the fiduciary’s own interest or for the fiduciary’s own account; acting in a transaction involving the plan on behalf of a party whose interests are adverse to the interest of the plan or its participants or beneficiaries; and receiving any consideration for the fiduciary’s own personal account from any person dealing with the plan in connection with any transaction involving plan assets.

Should you encounter a situation that creates any doubt as to whether a transaction may be considered a prohibited transaction, or a violation of its cousin the Exclusive Benefit Rule (any plan-level decision must be for the exclusive benefit of the participants), please contact your plan consultant for clarification and/or an ERISA attorney referral.

Communication Corner: No More Excuses!

This month’s employee memo encourages participation in the company’s retirement plan and debunks common misconceptions regarding employees’ inabilities to save for retirement.

If you have an interest in distributing the employee memo please call or email Lee Pierce at lee@piercefinancial.org or 901-271-3720.