The Meaning of *Tibble*

Monitoring funds, purchasing power, true costs and more

What is the meaning of *Tibble v. Edison International* for plan sponsors? To answer that, we need to ask, which *Tibble* decision are we talking about? There are decisions from three different courts—the Supreme Court, the trial court and the court of appeals.

All three courts dealt with the statute of limitations, which is a legal concept saying you can't litigate issues that are "old and cold." The specific issue was whether the time limit begins to run when an investment—e.g., a mutual fund—is initially selected for the plan or whether there is a separate time limit for monitoring that begins anew each year. Both the trial court and the court of appeals held that if fiduciaries imprudently selected an investment, participants could not file a lawsuit more than six years after the initial selection unless a significant change had occurred.

The Supreme Court overturned those decisions and held that there was a separate duty to monitor investments and that that duty had its own six-year statute of limitations. While this decision is of great interest to lawyers, it isn't much of a lesson for plan sponsors, because regularly monitoring the investments is a common practice for them.

But, on a different issue, the trial court and court of appeals held that plan sponsors have to consider their plan's "purchasing power" when selecting investments. This issue was not appealed to the Supreme Court. As a result, the court of appeals' decision is the final word.

For example, a small 401(k) plan might be limited to retail mutual funds called "A" shares, while a large plan might be able to purchase institutional, or "I," shares. Both the A and I shares are investments in the same fund. The only difference is the participants in a small plan are paying a higher "expense ratio," because they own retail shares, than the participants in a large plan would, because they have institutional shares.

While the courts didn't go beyond the duty to consider a plan's ability to buy less expensive share classes, the same theory could apply where a plan obtains investments through collective trusts or separately managed accounts that are virtually identical to a particular mutual fund. It's not much of a reach to say that plan committees should consider the plan's purchasing power when the alternatives are the same as a higher-cost version of the investment.

Then, there is another way to look at the *Tibble* decisions. Most people think that institutional shares are cheaper than retail shares, but that is not always the case. Fiduciaries need to evaluate the "true cost" of plan investments. The true cost is the investment's net cost. In many cases, mutual funds pay revenue sharing to a plan's recordkeeper to reduce the cost of administrative services for the funds. In some cases, the true cost of the retail shares of a mutual fund, when reduced by the fund's revenue sharing, is less than that for the institutional class.

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For example, if the expense ratio of the I shares is 0.60% and the expense ratio of the A shares is 0.80%, the institutional share class looks like a better deal. But what if the revenue sharing paid by the A shares is 0.25%, and the I shares do not pay revenue sharing? When you reduce the retail expense of 0.80% by 0.25%, its true cost or net expense ratio is 0.55%. The net cost of the A shares is actually cheaper.

Those revenue-sharing payments are commonly used to reduce plan expenses, such as recordkeeping fees, which benefits the participants. In recent years, though, some plans have begun allocating revenue sharing back to the participant who owned the fund that generated the payment. That is referred to as "equalizing" or "levelizing" the revenue sharing.

When committee members are educated on these issues and examine the expense ratios and revenue sharing of their mutual funds, they often find that it is fair to return the revenue sharing to the participant who generated it and give him the benefit of the net cost, rather than using it to benefit participants as a whole, by, for example, using it to pay the recordkeeper. That is particularly true where revenue sharing varies from fund to fund, so that, unless the revenue sharing is equalized, some participants would end up paying more than others for the plan.

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