# Employers must monitor 401(k) fees, Supreme Court rules

By DEAN STARKMAN AND DAVID G. SAVAGE

In a move that could brighten retirement prospects for millions of Americans, the U.S. Supreme Court ruled that employers have a duty to keep watch over 401(k) plans to guard against high management fees that can erode retirement savings.

A unanimous high court said Monday that employers can be sued if they fail in their "continuing duty to monitor" mutual funds in 401(k) accounts for unnecessarily high fees, potentially shaking up the $5.8-trillion market for administering the plans.

The decision involving Edison International in Rosemead surprised analysts both for its sweep and the agreement of the frequently fractured court. The ruling effectively shifts the burden in disputes over monitoring retirement plans from workers to the employers that administer them.

Employees long have been saddled with 401(k) plans that limit investment choices and provide no way to negotiate for better plans or lower fees. Workers are left largely to themselves to fund and oversee their retirement plans.

Management fees typically are buried deep in retirement documents and can go unnoticed by most workers. They are small — a percent or two of total assets — but they can do major damage to an investment portfolio over time.

A 1% fee on a $100,000 portfolio, for instance, would cost a retirement fund $30,000 more than a fee of 0.25% over two decades, assuming an annual 4% rate of return, according to the Securities and Exchange Commission.

Put another way, an employee with the lower-cost fund would have $30,000 more for retirement. The larger the nest egg, the wider the gap would be.

The Supreme Court decision is the second major setback this year for Wall Street and the rest of the financial services industry, which in recent decades has taken over managing an increasing share of the nation's retirement system. Though the court decision applies to employers, the industry will be pushed to lower fees.

Last month, the U.S. Department of Labor formally proposed a new rule that would require investment advisors to put clients' interests first across a broad swath of retirement-related transactions. That bitterly contested rule has big implications for the $6.5-trillion market for individual retirement accounts, which differ from 401(k)s in that the personal accounts don't involve employers.

Teresa Ghilarducci, a labor economist and retirement scholar at New York's New School, said both the Labor Department proposal now out for public comment and the Supreme Court decision together represent a major shift in the retirement policy discussion.

Spreading through Washington is the notion that "regulation kind of fell down on the job and that the industry has overwhelmed regulators," she said. Now "everyone really wants to be on the side of retirees."

In a 2007 lawsuit, Edison employees accused the energy giant of violating its fiduciary duty under the 1974 Employees Retirement Income Security Act by offering six higher-priced retail class mutual funds as plan investments when essentially the same funds were available under lower-cost institutional shares.

The suit, Tibble vs. Edison International, was brought as a class-action on behalf of 20,000 employees and retirees. Lower courts, including the U.S. 9th Circuit Court of Appeals in San Francisco, invalidated claims involving three funds because a six-year statute of limitations had elapsed. The rest were upheld.

In overturning the appellate court on the statute of limitations, Justice Stephen G. Breyer said the plan overseers have “continuing duty “to” monitor and improve investments.

"This continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset," he wrote for the high court.

The decision is likely to give a boost to several other class-action suits pending against major employers.

"This decision means you can't put it on autopilot," said Jerome Schlichter, a St. Louis lawyer for the plaintiffs. "The fees must be reasonable. But it is not all that difficult. In a case like this, all it takes is a phone call, and you can get a better rate."

Lauren Bartlett, a spokeswoman for Edison subsidiary Southern California Edison, said the court's ruling focused on "six mutual funds that were removed from the plan's investment lineup years ago."

The company is "committed to providing a wide array of high-quality investment options in the plan," she said, and Monday's court opinion "does not question our loyalty to plan participants."

Some management lawyers downplayed the decision and noted that the court did not spell out a standard for deciding when a company violated its duty to its employees. "I don't see this decision as a game changer," Washington lawyer Brian Netter said.

He said the decision may open the door to more litigation, but noted: "I don't think Tibble makes it easier for plaintiffs to prove a case."

Others, though, see a major change. The ruling will send a "shock wave to the retirement-provider community and force them to discharge their fiduciary duties and protect people's savings," said Dennis Kelleher, chief executive of Better Markets Inc., a Washington financial reform group.

Boston employment lawyer Marcia Wagner said the decision is warning companies that "you've got to have a damned good reason to pay higher fees if you don't have to — a really, really, really good reason."

The backdrop to the case is a decades-long sea change in retirement policy in which most workers' pensions have shifted away from so-called defined benefit plans managed by professional investors, which provided a guaranteed income.

Now, most employees have defined contribution plans, such as 401(k)s and IRAs, that require them to make major investment decisions and bear the risk that returns over the life of the plan will be robust enough to meet their retirement goals.

In 1978, conventional pensions accounted for nearly 70% of all U.S. retirement assets, according to a White House report published in February. By 2013, such pensions accounted for only 35% of retirement assets, and defined contribution plans and IRAs accounted for more than half.

Critics have argued that the patchwork system is falling short in crucial areas, many of them tied to the labor market, which hasn't provided the kind of income growth that enables workers to fund the accounts adequately.

Increasingly, federal policymakers and Main Street investors have turned their attention to the more manageable problem of fees paid to such investment firms as Vanguard Inc. and Fidelity Investments to manage the mutual funds and other products within the plans.

Observers said the Supreme Court decision would heighten responsibilities of 401(k) plan administrators, who are already fiduciaries under ERISA but may not be exercising the proper diligence.

Ghilarducci said the immediate result of the decision might be a big shift away from higher-cost actively managed mutual funds to low-cost indexed funds as managers search for options that can clearly be justified based on cost.

"The biggest winner today is Vanguard," she said, referring to the firm that charges among the lowest fees.

A spokesman for Vanguard declined to comment on the Supreme Court case. He said the company "has always encouraged defined-contribution plan sponsors to assemble a prudent line-up of reasonably priced investment options to help their participants achieve better retirement outcomes."

Ghilarducci said the main import of the decision is that plan administrators will have to spell out their reasons for choosing high-fee funds.

"On average, for 50 years, active managers have never been able to beat the index consistently," she said. "That truth is known. And now employers are responsible for recognizing that truth."

*Starkman reported from New York; Savage from Washington, D.C.* | 