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Advocate's VIEW

Pooled funds present challenges

Congress enacted the Employee Retirement Income Security Act of 1974 for the purpose of securing benefits for retiring workers.

Although the recent trend is to reduce fiduciary responsibility and increase participant control through participant-directed investing, many ERISA plans either still have pooled investments or may be subject to claims of imprudent investment decisions prior to conversion.

Because industry practice is not always completely in line with statutory expectations, litigation involving pooled retirement funds presents unique challenges.

ERISA requires retirement plan fiduciaries to act prudently with respect to assets under their control. If a fiduciary fails to do so, he or she may be sued in U.S. District Court for breach of fiduciary duty, and required to "make good to such plan any losses," among other possible relief.

To properly analyze potential liability in the context of actual or threatened litigation, one must understand who an ERISA fiduciary is and what responsibilities are undertaken with respect to retirement plan investments.

By STEVEN E. COLE

Daily Record Columnist

To determine who an ERISA fiduciary is with respect to a plan's investment assets, review the statute, the retirement plan's provisions and any contracts with third parties related to investment of the plan's assets. Investments are to be held in trust and managed by trustees who generally have "exclusive authority and discretion to manage and control the assets of the plan." Such authority may be delegated to one or more investment managers, who are given discretionary authority to make decisions on the plan's behalf with respect to investments under their control. That does not relieve the trustees of all responsibility with respect to the plan investments, however.

The other plan fiduciaries retain responsibility for, among other things, hiring the investment manager and overseeing performance. They must do so prudently, and cannot claim lack of experience or expertise in investments as an excuse.

Practically speaking, that means the other plan fiduciaries must put themselves in a position to determine whether the investment manager is investing the plan's assets in a manner consistent with the plan's investment objectives and tolerance for risk. Best practices suggest a written investment policy is the preferred method of ensuring the investment manager and the trustees have reached a consensus concerning the plan's investment objectives.

The investment manager generally is responsible for understanding and implementing the investment policy, provided the policy itself is not imprudent. There is no requirement under ERISA for a plan to have a written investment policy; however, the lack of a written investment policy makes it far more likely the trustees and investment manager will disagree about the specifics of the plan's investment objectives after the fact if the plan's investments perform poorly.

In the absence of contemporaneous documentation, the plan's investment policy ultimately may be decided at trial by a judge, years after the fact, based on hours of testimony and reams of documents.

In addition to having a written investment policy, an investment manager can find protection from misunderstandings by reviewing plan documents and including provisions that clearly allocate responsibilities in the investment management agreement. ERISA does not allow a fiduciary to contractually limit statutory responsibilities, but the agreement can clearly delineate and confirm that the trustees are responsible for formulating the plan's investment policy. When a plan consists of multiple portfolios and multiple managers, for instance, the manager of a specific portfolio should not be expected to analyze the plan's overall objectives or determine whether the investment objectives assigned to a specific portfolio are imprudent. The investment management agreement should make clear that responsibility does not belong to the investment manager. Responsibility for overall investment policy also should be addressed in plan documents, which an investment manager should review prior to executing any agreements with the plan.

Those who actually exercise discretionary control over plan assets are considered fiduciaries, no matter whether they are designated a fiduciary by any plan document or contract. That includes employees or principals of the investment manager who make investment decisions, and also may include the employer's management personnel, to the extent that they give orders to an investment managers to buy or sell plan assets.

Plan fiduciaries and investment managers cannot insulate themselves from volatility in the investment markets; however, the clear allocation of responsibility and a written expression of

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plan investment policies should help to define fiduciaries' roles with respect to investments. Such clarity also reduces the likelihood that fiduciaries who fulfilled their responsibilities will be held responsible for the acts or omissions of other fiduciaries who did not.

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