

The fiduciary duty to investigate plan investments

By Marcia S. Wagner, Esq.

Section 404(a)(1)(B) of ERISA requires the fiduciary of a benefit plan to act with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Most cases that have addressed the issue of prudence concern a fiduciary's plan investment decisions. In addition to prudence in investment decisions, Section 404(a)(1)(C) of ERISA requires that investments be diversified so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

Investment decisions are generally tested by examining the process undertaken by plan fiduciaries, that is, whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment. If an investment is subject to prudent investigation, plan fiduciaries will not be held responsible if unexpected losses occur as a result of making or maintaining the investment.

While fiduciaries are advised to periodically review the investment program that they have established and to document such reviews, what are the consequences if they neglect those steps? A recent decision by the Fourth Circuit Court of Appeals clarifies that a technical breach does not always lead to liability. In *Plasterers' Local No. 96 Pension Plan v. Pepper*, former trustees of a multiemployer pension plan had invested plan assets exclusively in certificates of deposits and U.S. Treasury securities from the mid-1990s until 2005 during which time they failed to investigate investment alternatives. While plan assets had increased in value during this time, successor plan trustees thought their predecessors would have done better by investing 50% in an S&P index fund and 50% in a bond fund and, consequently they sued the former trustees for imprudence in failing to investigate investment alternatives as well as the failure to diversify investments.

The district court found that the trustees had, in fact, breached their fiduciary duty, causing the plan to suffer losses of more than \$432,000 which the plaintiffs' expert claimed would have been earned by undertaking the new trustees' alternative investment program in the three years ending with 2005. On appeal, the Fourth Circuit acknowledged that the former trustees had committed a fiduciary breach. However, this was insufficient to establish, as a matter of law, that the actual investments were imprudent. In the words of the Fourth Circuit, "ERISA requires an independent finding of causation of loss before liability for a breach of fiduciary duty is incurred." Thus, for a fiduciary to be held liable, it must be shown that the fiduciary's conduct actually led to the losses.

Accordingly, the district court's award of damages based on the difference between the actual plan value at the end of a specified three-year period and the plan value plaintiffs' expert testified could have been achieved was vacated and the case remanded to the district court for a decision on the issue of causation.

In remanding the case to the district court, the Fourth Circuit avoided telling the lower court which conclusions to reach on the issue of whether the conduct of the former trustees had been prudent. However, it did direct the lower court to determine the circumstances informing the former trustees' decision-making, including the plan's size and type, the plan members' demographics, and the plan's investment goals and objectives. The last of these was presumably of particular importance, because the plan had been established to replace another plan which had experienced severe investment losses, and a primary objective of the defendant trustees was the avoidance of further losses.

The Fourth Circuit also indicated its dissatisfaction with the methodology previously used by the district court to determine damages, indicating that comparison of actual investment results for the final three years of the defendant trustees' tenure with the investment results that would have been achieved if the plaintiffs' proposed investment program had been adopted was arbitrary because of the period involved. The Fourth Circuit noted that the defendant trustees had argued that if the period for comparison were extended to six years, their actual investments would have outperformed the proposed model. Thus, the district court was directed to articulate a reasoned basis for selecting the timeframe to make the comparison.

Conclusion

The Fourth Circuit's ruling in the *Plasterers'* case is a reminder that liability for breaching the fiduciary duty to investigate and diversify retirement plan investments occurs only when the plan incurs an actual quantifiable loss. However, the expenditure of significant resources in litigation in that case could have been avoided if the defendant trustees had conducted periodic reviews of the merits of their investment program. During the course of an investigation into an existing investment, if an area of dissatisfaction is identified, the responsible fiduciary must decide if further action should be taken. If the investment does not improve, it should be replaced with an alternative. ♦

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