Limited Liability of a Trustee

ERISA constricts that fiduciary's duty of prudence

Plan sponsors may have an understanding of the different levels of fiduciary responsibilities under the Employee Retirement Income Security Act (ERISA) for discretionary trustees and directed trustees, but may not appreciate fully the implications of those distinctions, which were emphasized by a 2017 case in the Southern District of New York, Harley, et al., u. Bank of New York Mellon. In that case, a series of miscommunications between the plan sponsor's investment committee and the Bank of New York resulted in funds that were intended to be invested in equities being invested in cash equivalents, with a loss to the plan of $1.7 million. While the bank's conduct had negative consequences and its services as a directed trustee were terminated, it can be argued that its standard of services did not fall below the standard of services established under ERISA for a directed trustee.

The fiduciary duties of a directed trustee under ERISA are "extremely narrow."

Under ERISA Section 403(a), where a plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, the trustee is subject to "proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to" ERISA. As a result, the fiduciary duties of a directed trustee under ERISA are "extremely narrow," and are "significantly lower than the duties generally ascribed to a discretionary trustee under common law principles." That is, a directed trustee's fiduciary liability is limited to instances in which it fails to follow proper directions of a named fiduciary or it complies with directions that are improper, or contrary to the plan or ERISA. While a directed trustee must discharge its own duties in conformity with the prudent man standard of care, courts have indicated that a directed trustee's duty of prudence is "quite constricted."

In F.W. Webb Co. v. State Street Bank and Trust Co., the District Court for the Southern District of New York wrote, "typically, a directed trustee is only charged with knowledge that an investment instruction is imprudent where the trustee possesses nonpublic information that a company's financial statements are false or where it possesses public information showing with near certainty that a company is on the brink of collapse." That analysis is consistent with the position of the Department of Labor (DOL) in Field Assistance Bulletin (FAB) 2004-3 that, with respect to determining the prudence of a particular investment, generally the directed trustee has no obligation to evaluate the merits of a named fiduciary's investment directive, absent its possession of material nonpublic information regarding the security.

In this case, plaintiffs argued that it was not prudent for BNY Mellon to reallocate $15 million from one cash account to another, an investment decision that made no sense in the context of the plan and the direction given: "No prudent trustee could have thought Wellspan wanted to pointlessly transfer millions of dollars from account to account only to end up in the very same money market fund."

However, because of the very limited role of a directed trustee, BNY Mellon had no obligation to advise the plaintiffs that its investment direction was imprudent, or to reach out to plaintiffs and suggest that it do something different.

In Harley, the District Court also considered, and rejected, plaintiffs' course of performance arguments for imposing a fiduciary duty. As it applied to the particular case, plaintiffs argued that BNY Mellon knew when it needed wire instructions to execute investment instructions and when it did not, but the firm never provided the plaintiffs with a clear and uniform list of when wire transfer instructions were or were not needed.

Plaintiffs further contended that, in light of BNY Mellon's knowledge and their own lack of knowledge of when wire transfer instructions were needed, BNY Mellon had consistently alerted the plan, either verbally or in writing, when wire instructions were needed. The District Court was unpersuaded. It acknowledged that, while it may have been good customer service to do so, BNY Mellon did not, as a directed trustee, have a responsibility under ERISA to educate plaintiffs about how to prepare investment instructions or advise plaintiffs on an unsolicited basis as to how best to implement its intentions.

Takeaway: Best practices for a directed trustee might be to take a particular action, but a directed trustee is not legally obligated under ERISA to adhere to a best practices standard, so its failure to do so does not result in a breach of fiduciary liability.

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