

PRUDENT PRACTICES FOR INVESTMENT FIDUCIARIES

PRACTICE SA - 1.2

The roles and responsibilities of all involved parties (fiduciary and non-fiduciary) are defined, documented, and acknowledged.

ERISA Requirements

A fiduciary must 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. [ERISA §404(a)(1)(B)]

The prudence standard is that of a hypothetical person who is “familiar with such matters.” As a result, the standard requires that a fiduciary for a retirement plan be familiar with the issues and responsibilities of the management of an enterprise that is worth investing for retirement benefits.

A fiduciary’s conduct is to be judged against a presumption of a high degree of knowledge.

The prudence standard charges fiduciaries with a high degree of knowledge. The standard measures the decisions of plan fiduciaries against the decisions that would be made by experienced investment advisers. [Joint Committee on Taxation, Overview of the Enforcement and Administration of the Employee Retirement Income Security Act of 1974, at 12 (JCX-16-90, June 6, 1990)]

Ignorance of the duties imposed on a fiduciary is no excuse. A fiduciary who is not aware that he is violating the fiduciary duties of ERISA is still liable for the violation. The ERISA standard of conduct is an objective one; good faith is not sufficient.

A trustee’s lack of familiarity with investments is no excuse: under an objective standard, trustees are to be judged according to the standards of others acting in a like capacity and familiar with such matters. [Marshall v. Glass/Metal Association and Glaziers and Glassworkers Pension Plan, 507 F. Supp. 378, 2 E.B.C. 1006 (D. Hawaii 1980). See also, Katsaros v. Cody, 744 F.2d 270, 279, 5 E.B.C. 1777 (2d Cir. 1984), cert. denied, 469 U.S. 1072, 105 S. Ct. 565, 83 L.Ed. 2d 506 (1984), where the trustees, who lacked familiarity with investments and were ill-equipped to evaluate the soundness of a proposed loan, were held liable for breach of fiduciary duty due to their failure to seek outside assistance to help them.]

Practice SA – 1.2 (continued)

Especially with regard to investing plan assets, a fiduciary must act as a prudent and knowledgeable person would under similar circumstances, taking into account all relevant factors as they appeared at the time of the investment decision, not in hindsight. This is generally referred to as the “*prudent expert rule*.” Said the court in *Marshall v. Snyder*, 1 E.B.C. 1878 (E.D.N.Y. 1979):

... the framers of §404(a)(1)(B) established a standard of conduct based on a measure of how a prudent man in a like capacity (administration of employee benefit plans) and familiar with such matters would act. Thus, ERISA’s prudence test is not that of a prudent lay person but rather that of a prudent fiduciary with experience dealing with a similar enterprise. [Marshall at 1886]

Under ERISA, the fiduciary is held to the so-called prudent expert rule even if he lacks the capabilities required to carry out his fiduciary responsibilities. Under these circumstances, he must engage experts who have the requisite skill, knowledge, and experience needed by the plan. [*Donovan v. Mazzola*, 716 F.2d 1226, 4 E.B.C. 1865 (9th Cir. 1983)] However, the fiduciary retains the ultimate responsibility for the decision.

A fiduciary’s independent investigation of the merits of a particular investment is at the heart of the prudent person standard. [Fink v. National Savings and Trust Company, 772 F.2d 951, 957, 6 E.B.C. 2269 (DC Cir. 1985)]

So by failing to make any independent investigation and evaluation of a potential plan investment, the fiduciary in *Fink* was held liable for breach of fiduciary obligations.

Fiduciary decisions will be scrutinized based on the care the fiduciary took in investigating the facts beforehand. In *Donovan*, the court stated that the test for prudence was

whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment. [Donovan at 1232]

The duty to investigate inherently presupposes an understanding of the fiduciary’s duties, and failure to be aware of one’s duties can constitute fiduciary breach under ERISA.

UPIA and UPMIFA Requirements

The UPIA and UPMIFA impose the obligation of prudence on trustees. UPIA states:

... [A] trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this [Act]. [UPIA §1(a). See also, UPMIFA §3(b)].

Practice SA – 1.2 (continued)

The standards of care under the UPIA and UPMIFA are similar to that required by ERISA: to act as a prudent person would. As described in UPIA §2, the standard is that of a prudent investor similarly situated:

[a] trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution. [UPIA §2(a); See also, UPMIFA 3(b)]

The trustee has a duty to monitor and investigate. As stated in UPIA §2(d):

A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets. [See also, UPMIFA §3(c)(2).]

The Comments to the Act note that “managing” includes monitoring, or the trustee’s continuing responsibility to oversee the suitability of investments already made as well as those that are new. Subsection (d) also describes the traditional fiduciary responsibility to examine information likely to have importance regarding the value or security of an investment.

MPERS Requirements

MPERS requires the fiduciary (*i.e.*, the trustee) to understand and be aware of its duties. The language of MPERS is virtually identical to the language of ERISA and the discussion earlier in this memorandum applies here as well.

General fiduciary duties under MPERS are enumerated in §7 and mirror the duties described in ERISA, sounding the well-recognized trust duties of loyalty and prudence:

A trustee or other fiduciary shall discharge duties with respect to a retirement system:

(1) Solely in the interests of plan participants and beneficiaries;

(2) For the exclusive purpose of providing benefits to participants and beneficiaries ...; and

(3) With the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose [MPERS §7(1-3)]

Practice SA – 1.2 (continued)

What sets MPERS apart from ERISA is that these duties apply in the public retirement system setting. The Comments to §7 note that, in the public retirement system setting, the duty of loyalty includes the obligation to set aside the interests of the party that appoints a trustee or fiduciary. The trustee must act solely in the interests of participants and beneficiaries, and not in the interests of the union or employer responsible for the trustee's appointment. *See National Labor Relations Board v. Amax Coal Co.*, 453 U.S. 322, 101 S. Ct. 2789, 69 L.Ed. 2d 672 (1981), where the Supreme Court looked to the language and legislative history of §302(c)(5) of the Labor Management Relations Act, 29 U.S.C.S. §141 et seq. (as well as ERISA) and reasoned that:

[they] therefore demonstrate that an employee benefit fund trustee is a fiduciary whose duty to the trust beneficiaries must overcome any loyalty to the interest of the party that appointed him. [NLRB at 2796]