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Fiduciary Implications of the Market Crisis

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Agenda

- Madoff Issues
- Procedural Prudence
- Investment Policy Statements
- Changing Managers
- Participant Disclosure
- Private Fund Issues
- Fiduciary Delegations
- Role of Investment Consultants
- Money Market and STIFs
- Securities Lending
- Protection from Liability

Madoff

- Illustrative of many of the items we'll discuss today
- Types of possible claims
- *Pension Fund for Hospital and Health Care Employees-Philadelphia and Vicinity v. Austin Capital Management Ltd.*, E.D. Pa., No. 2:09-cv-00615-PBT
- DOL Guidance

Process, Process, Process

- Fiduciaries not judged by results, judged by process
 - Did the fiduciary act in a way that a prudent expert would have acted?
 - Use of consultants
 - Hiring appropriate investment managers
 - Conducting due diligence
 - Monitoring delegates
 - DOL Boston office letter

Process, Process, Process

- Is that process properly documented?
 - Minutes
 - Policies
 - Regular meetings
 - Due diligence

Investment Policy Statements

- What is it?
 - sets forth investment goals
 - establishes procedure for selection and removal of managers
 - establishes benchmarks and asset allocation
 - sets forth prohibited investments
- Why have one?

Investment Policy Statements

- What level of detail should it contain?
- Should review in light of market crisis
- Making changes to IPS
 - Seek expert advice
 - Evidence of prior breach?
 - Long-term investment strategy
 - Hardwiring investments in plan document

Changing Managers

- Changes in managers could be highly scrutinized
 - Reason for change
 - Performance
 - Change in ownership
 - Loss of key personnel
 - Style drift
 - Litigation
 - Reallocation
 - Process
 - RFP
 - Use investment consultant
 - Interviews
 - Gates and termination provisions

Changing Managers

- Transition issues
 - In-kind transfers vs. cash
 - Consider hiring a transition manager
 - Will new manager take toxic investments?
 - Ring-fence the investment
 - Who will be responsible for the investment?
 - Plan investment committee
 - Ring-fence manager

Participant Disclosure

- Need to be very careful about what you say to participants
 - Do not give investment advice
 - Education is acceptable
 - Do not make representations about the quality of your service providers and managers
 - Employer stock issues
 - Limit informal communications
 - Limit who can communicate relating to plan
 - Document all communications

Plan Asset Issues

- DOL plan asset regulation describes when assets of an entity in which a plan invests will be considered to include ERISA plan assets
- Where an ERISA plan invests in an equity interest of an entity, assets of the plan include an undivided interest in the underlying assets of the entity, unless, among other things, equity participation in the entity by benefit plan investors is not “significant”

Plan Asset Issues (cont'd)

- Equity participation is “significant” if, immediately after most recent acquisition of an entity interest, 25% or more of total value of any class of equity is held by “benefit plan investors”
- Declining returns and liquidity needs may prompt redemption requests
- If redemptions are made disproportionately by non-benefit plan investors, benefit plan investment could exceed 25%

Plan Asset Issues (cont'd)

- Redemption by one investor could be treated as an acquisition by other fund investors
- Significant consequences of holding ERISA plan assets

Fiduciary Delegations

- Are you investing in non-plan assets entities?
 - Mutual funds
 - Insurance company guaranteed contracts
 - Private equity funds
 - Real estate funds
 - Hedge funds
 - Insurance company separate accounts

Fiduciary Delegations

- Are you investing in plan assets entities/accounts?
 - Separately managed accounts
 - Hedge funds/side pockets
 - Private equity funds (rare)
 - Bank collective funds
 - Insurance company separate accounts
- If yes
 - Manager of fund is fiduciary to the investing plan
 - Proper delegation protects plan trustees/named fiduciary
 - ERISA section 3(38) Investment Manager

Investment Consultants

- Do you know what role your investment consultant is playing?
 - Fiduciary vs. non-fiduciary
 - Review your contract
 - Conflicts of interest
 - Review your investment policy statements
 - Is the role of the consultant fairly stated and consistent with the contract?
 - Written investment recommendations/meeting minutes
 - What documentation do you have?

Money Market and Short Term Investment Funds (STIFs)

- Minimal or no yield investments
 - Can it ever be prudent to invest plan assets in an investment that has minimal or no yield?
 - Risk vs. return
 - Use of the investment in an overall portfolio
 - Current market conditions/alternatives
 - Review the fund's investment guidelines
 - Document who chose the STIF
 - Named fiduciary/investment consultant/investment manager

Securities Lending

- *BP Corp. Savings Plan Investment Oversight Committee v. Northern Trust*
 - Issue: In-kind Distribution from Cash Collateral Account
- Complaint Filed – *Board of Trustees of the AFTRA Retirement Fund v. J.P. Morgan Chase Bank*
 - Allegation of Imprudent Investment of Cash Collateral

Disposal of Troubled Assets

- Exemptions for Citigroup, Robert W. Baird & Co. and Raymond James & Co. to cover sale of auction rate securities to employer or IRA owner
- Exemption for sale of auction rate securities to Northwestern Mutual Investment Services
- Proposed exemption for sale of auction rate securities to Morgan Stanley

Protection from Liability

- **Fiduciary insurance**
 - For the plan
 - For managers
 - For consultants
 - Review periodically
 - Review credit-worthiness of insurer
- **Indemnities**
 - From plan – not permitted
 - From plan sponsor
 - From fiduciaries
- **Bonding**
 - In light of scandals, are minimum amounts appropriate?
 - DOL guidance

Questions?

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