

LEGAL UPDATE

Duty to Monitor

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There is general agreement with respect to the duty of monitoring under ERISA. The applicable principles have been relatively unchanged since 1975 when the DOL stated that, at reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that the performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan. More recently, in a 2003 amicus brief, the DOL indicated that, in most instances, it will be enough if appointing fiduciaries adopt and adhere to routine procedures sufficient to alert them to deficiencies in performance which could require corrective action, such as the implementation of a system of regular reports on the investment fiduciaries' decisions and performance. However, two recent District Courts elaborated on certain aspects of

the duty to monitor, a duty which extends to reviewing the performance of investment advisors.

For example, the duty to monitor does not carry with it the duty to review an investment fiduciary's every decision. *Howell v. Motorola, Inc.*, 633 F.3d 552 (7th Cir. 2011). This is the rule even during a financial crisis, such as the collapse of Bear Stearns. *In re Lehman Brothers Security and ERISA Litigation*, 113 F. Supp. 3d 745 (S.D.N.Y. 2015). To conclude otherwise would defeat the purpose of hiring investment fiduciaries to run a plan in the first instance. As the DOL explained in its amicus brief in 2003, "appointing fiduciaries are not charged with directly overseeing the investments [as that would be] duplicating the responsibilities of the investing fiduciaries." However, in *Reetz v. Lowe's Companies, Inc.*, the District Court for the Western District of North Carolina held that, assuming without deciding that

the duty to monitor does not extend to individual investments, the duty to monitor, extends, at a minimum, to situations where the Administrative Committee directs or approves the transfer of nearly half the plan's assets other than company stock, totaling more than \$1 billion, into a single investment fund operated by the Plan's fiduciary advisor. The scale of the decision made results in a plausible inference that defendant violated the 1975 DOL regulation quoted above by failing to monitor the investment "in such manner as may be reasonably expected to ensure that its performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan." In this regard, investment advisors should be aware of case law for the proposition that the failure to monitor the continued prudence of an investment may breach the duty of prudence even if adequate monitoring would have produced the same result. See, for example, *Board of Trustees of Operating Engineers Pension Trust v. JP Morgan Chase Bank NA* (S.D.N.Y. 2013).

The second case, *DOL v. Severstall*, deals with the timing of the duty to monitor. There is no question that a fiduciary who ignores changed circumstances that have increased the risk of loss may be guilty of imprudence. While in most circumstances, depending upon the size of a plan, semiannual or quarterly meetings will be sufficient, a plan's investment policy should provide that in the event of unusual or extraordinary circumstances, the applicable fiduciary should consider taking action more promptly. In *Severstall*, the District Court for the Western District of Pennsylvania explained that a fiduciary's obligation to act is triggered when it has notice

of the appointee's misconduct or has information available to it from which the misconduct would be apparent. *Secretary of Labor v. Doyle*, 657 Fed. Appx. 117 (3d Cir. 2016). The issue for the District Court was, therefore, the timing of when defendants were aware of a breach of fiduciary duty by a third party. The DOL conceded that the defendants were not on actual notice of the breach until they received a 2008 quarterly report from Mercer. Once the defendants received that report, they promptly took action. The District Court disagreed with the DOL's expert that the duty to monitor becomes heightened during an economic crisis.

The District Court also noted that both experts agreed that markets were volatile at this time, it was industry standard to allow investors time to correct a mistake, and there is an inherent danger in leaving a fund unmanaged. Tellingly, neither the DOL nor its expert indicated the date at which the investment manager should have been terminated.

Takeaway – while a duty to monitor is a derivative claim, which means that it is only applicable if an investment advisor has breached its fiduciary duty, the DOL's aggressive posture in this case in seeking to enforce the duty to monitor may result in the relevant plan fiduciaries monitoring more extensively or more frequently the conduct of investment advisors.

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