Investment Manager Obligations

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Although there is no shortage of cases alleging breaches of fiduciary duty in managing a 401(k) plan, not many of them flesh out with any degree of specificity what the obligations of an investment manager are. A Magistrate's report in the case of *Birza v. Century Link in District of Colorado* does just that, and while the District Court may not follow the recommendations of the Magistrate, but they are nonetheless worth taking note of.

First, with respect to the duty of prudence, the Magistrate stated that the fact that a fiduciary has undergone a robust investigation of an investment does not in and of itself relieve the fiduciary of liability if the circumstances reflect a breach of duty, despite the rigorous investigation. It explained that a fiduciary is under a duty to exercise reasonable prudence in selecting investments, and this objective reasonableness standard is applied to the subjective needs of the fund, which is why ERISA's prudence requirement concludes with the words "conduct of an enterprise of a like character and with like aims." It quoted the language of the Third Circuit in *In Re Unisys Savings Plan Litigation* that "the prudence requirement is flexible, such that the adequacy of a fiduciary's independent investigation and ultimate investment selection is evaluated in light of the character and aims of the particular type of plan he serves." From a procedural perspective, the Magistrate also stated that the adequacy of a fiduciary's investigation is a flexible, context-specific inquiry not usually appropriate for resolution in the context of a Federal Rules of Civil Procedure 12(b)(6) motion to dismiss, which would allow a case to proceed to the discovery stage.

The Magistrate also addressed the duty to monitor. It stated that fiduciaries are under a continuing duty to conduct a regular review of these investment decisions and remove those investments which, although perhaps initially prudent, have become improper to retain. It explained that in making a claim of a failure to exercise the duty to monitor, a plaintiff must allege either that the fiduciary engaged in a deficient review process or that no review occurred at all, and that if the review had occurred or not been deficient, no reasonable prudent fiduciary would have retained the investment. Interestingly, its approach for analyzing procedural prudence in this connection seems based upon *Dudenhoeffer*, although the Magistrate did not cite that case.

It concluded that to establish a claim for failure to monitor, a plaintiff must establish that: (1) a review of the plan's investments should have been conducted, but either was not conducted or was faulty in some way; (2) but for the absence or deficiency of the former, the plan would have removed the investments; (3) no reasonably prudent fiduciary would have held onto the investment, taking into account the obligation to view an investment in the context of an entire portfolio; and (4) an alternative course of action could have prevented the plan's losses. The Magistrate's discussion also considered co-fiduciary liability under ERISA as between the appointing fiduciary and the investment manager. The Magistrate acknowledged that under ERISA, a fiduciary is under an affirmative obligation to remedy the breach of another if he has knowledge of the breach. It cited an earlier Second Circuit decision explaining that: "A fiduciary under ERISA turns a blind eye to improprieties at her great peril...An ERISA fiduciary may not avoid liability for mismanagement by simply doing nothing." However, in this instance, the co-fiduciary claim failed, because plaintiff could not show that the appointing fiduciary knew that the conduct in question constituted a breach; that is, to be liable for co-fiduciary liability, a plaintiff must show not only that the conduct occurred, but also that the conduct constituted a breach of the co-fiduciary's duties. Given that plaintiff's Complaint was its Third Amended Complaint, the Magistrate believed that plaintiffs should have been able to provide this type of factual support.

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