

MEMO# 1900

May 7, 1990

INVESTMENT ADVISER BREACHED FIDUCIARY DUTY UNDER ERISA

May 7, 1990 TO: INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 17-90 INVESTMENT
ADVISER MEMBERS NO. 18-90 PENSION MEMBERS NO. 21-90 RE: INVESTMENT ADVISER
BREACHED FIDUCIARY DUTY UNDER ERISA

_____ The United States Court of Appeals for the Eleventh Circuit held that an investment adviser breached its fiduciary duty under ERISA by failing to diversify a fund's assets adequately to meet the cash-flow needs of the fund. A copy of the court's decision is attached. The adviser was retained to manage Fund A, one of several funds in an employer's profit-sharing plan. The adviser was delegated sole authority to manage the Fund's assets. The Fund's portfolio was primarily invested in long-term government bonds. Less than a year after it began managing the Fund, the adviser received a letter from the employer stating that it needed a cash disbursement of approximately 20 percent of the value of the Fund as payments for retiring employees. To satisfy the employer's needs, the adviser had to sell a number of the long-term bonds at substantial discounts. Shortly thereafter, the employer terminated its contract with the adviser and filed a complaint against the adviser alleging that the adviser breached its fiduciary duty under ERISA. The appeals court agreed with the lower court's finding that the adviser breached its fiduciary duty under ERISA since it acted imprudently and failed to diversify the investments "so as to minimize the risk of losses, unless under the circumstances it is clearly prudent not to do so." Specifically, the court found that the adviser failed to investigate the particular cash flow requirements of Fund A and therefore did not adequately diversify the investment of Fund A's assets. The court noted that even though the adviser's investment strategy to invest in long-term bonds may have been a sound strategy, the adviser still breached his duty under ERISA since its decision failed to take into account the interests of the participants in the Fund, i.e., their particular cash flow requirements. Thus, a sound investment strategy for one plan's participants may not be in the best interest of another plan's participants. The court found that the adviser was liable for damages of \$537,000, which was the difference between the value of the Fund at the time the contract was terminated and the amount it would have been worth had it been invested according to a model introduced by plaintiff's expert. Amy B. Rosenblum Assistant General Counsel Attachment

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