

Financial Regulation

Worldwide regulatory developments and their implications for the financial services industry **international**

Plan fiduciary action in wake of US credit downgrade and global market fluctuations

In the wake of a recent downgrade of the US's credit rating and global market fluctuations, fiduciaries of employee benefit plans may be required to take immediate action to ensure that plan investments are made in accordance with plan policies and to otherwise discharge their fiduciary duties.

US credit rating downgrade

For the first time in its history, the United States has suffered a downgrade in its credit rating. On 5 August 2011 Standard & Poor's (S&P) reduced the USA's nation's credit rating to AA+ from AAA. Subsequently, S&P downgraded to AA+ from AAA its ratings for Fannie Mae and Freddie Mac and a number of other agencies linked to long-term US debt. It is expected that other AAA-rated insurance groups and state and local governments may have their ratings downgraded in the near future. However, Moody's Investors Service and Fitch Ratings have not downgraded their AAA credit ratings for the US at the present time.

Global market fluctuations

The recent credit rating downgrade, growing concern over the risk of a recession and other adverse market developments have had a dramatic impact on global markets, including yesterday's decline in the Dow Jones Industrial Average of over 600 points. Given recent economic and political developments, it is not expected that the US will regain its S&P AAA rating in the near future and it is expected that global financial markets will continue to fluctuate for some time.

Plan fiduciary action

Many employee benefit plans are invested in US Treasury securities and other US government instruments. Investment guidelines for many employee benefit plans prescribe minimum credit ratings for fixed income investments. In light of the recent credit rating downgrade and market fluctuations, plan fiduciaries should review their plan's investment policies to ensure that investments

are being made in accordance with such policies and should consider changes to plan investment policies and strategies.

Plan fiduciary duties

The Employee Retirement Income Security Act of 1974, as amended (ERISA) requires that fiduciaries of plans subject to ERISA:

- Discharge their duties to a plan solely in the interest of participants and beneficiaries;
- Discharge their duties for the exclusive purpose of providing benefits to participants and their beneficiaries, and defraying reasonable expenses of administering the plan;
- Act with the care, skill, prudence, and diligence that a prudent man acting in a similar capacity would use; and
- Diversify plan investments so as to minimize the risk of large losses (unless under the circumstances it is clearly prudent not to do so).

Plan fiduciary action checklist

In order to fulfill their fiduciary duties under ERISA, ERISA plan fiduciaries should, at a minimum, take the following actions with respect to plan investments:

Review plan investment policies

- Plan fiduciaries should review their plan's investment policies to ensure that the credit rating downgrade will not cause the plan to be in violation of the written terms of such policies.
 - For example, some investment policies require that fixed income investments may be made only in S&P AAA-rated government securities, or require a portfolio to have an average of an AA rating for all of its investments in fixed income securities. The recent credit downgrade by S&P could cause a plan to be in violation of such investment policies.
- In addition, plan fiduciaries should assess the overall impact of the credit rating downgrade and market fluctuations on both the fixed income investments and other plan investments,

such as asset allocation percentages and asset classifications.

- If the recent credit downgrade could cause a violation of the plan's investment policies or otherwise require a change in investment strategy, plan fiduciaries should consider whether it is prudent to amend such policies and/or change plan investments and, if a decision is made to do so, should take prompt action to make such amendments and investment changes.
- To the extent that a plan does not have a written investment policy, plan fiduciaries should consider implementing a written investment policy as soon as possible.

Plan fiduciary meetings

- Plan fiduciaries should meet to evaluate and discuss current investment policies and plan investments and to discuss any recommended changes to investment policies and plan investments.
- To the extent that independent plan fiduciaries, such as independent investment managers and non-directed trustees, and other investment advisors have been retained with respect to a plan, such independent plan fiduciaries and other investment advisors should be consulted to advise on recommended changes to the plan's investment policies and investments.
- To the extent that an independent plan fiduciary has not been appointed with respect to a plan,

appointment of such an independent plan fiduciary should be considered.

- In light of the recent events, plan fiduciaries may wish to meet more frequently to review plan investments.
- In light of the recent events, to the extent that such procedures are not already in place, plan fiduciaries may wish to implement procedures that will enable plan fiduciaries to make prompt decisions regarding plan investments, such as telephone meetings, decisions by unanimous written consent, and decisions made through electronic means.

Other plan fiduciary action

To protect against potential liability to plan participants for breaches of fiduciary duty, plan fiduciaries should carefully follow any applicable policies, and document their reasoning for determining the prudence of plan investments.

Documentation of the fiduciary decision-making process will be valuable in the event any action is brought against a plan fiduciary.

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