

MEMORANDUM

TO: Tribal Clients

FROM: Robert A. Burns, Esq.
Timothy D.S. Goodman, Esq.
Dorsey & Whitney LLP

DATE: April 19, 2004

RE: Mutual Fund Investigations

The Securities and Exchange Commission and a number of state attorney generals have been investigating mutual funds for trading abuses. Plan sponsors of retirement plans, including tribes and tribal entities, should pay close attention to these investigations. Regardless of whether ERISA applies to plans maintained by tribes and tribal entities,¹ tribes and tribal entities as plan sponsors are likely to be fiduciaries and responsible for the mutual fund investments offered in their plans.² This memo discusses the investigations and how to respond to the trading abuses.

Background

The investigations are looking into allegations that some fund companies allowed certain investors to rapidly trade in and out of funds (“market timing”), which reduces returns for long-term fund shareholders (including employees in retirement plans). It is also alleged that some fund companies permitted favored investors to invest based upon stale prices (illegal “late trading”), which also hurts other fund shareholders. If the shareholders of a fund in your retirement plan engaged in such practices, they harmed the rate of return received by your employees.

Response

Individuals who have the authority to select mutual funds investments are fiduciaries and have a duty to exercise prudence in the selection and retention of such funds. Fiduciaries should review the funds currently being used for plan investments and make an affirmative decision whether to retain such funds. If the funds are under investigation, this is a factor that must be considered in your decision. If you work with an investment advisor, you should contact the advisor and ask them to identify all funds currently used for retirement plan investments that are under investigation (and to identify any conflicts of interest the advisor may have with such funds). We are not suggesting that you remove funds currently under investigation. Fiduciaries, however, have a responsibility to consider whether or not the funds should be retained, restricted or removed. You should document your consideration of this question and the reasons for the conclusions you reach. Also, you should continue to monitor the situation periodically because additional funds may come under scrutiny in the future for these same reasons or for other reasons.

¹ See our article entitled “Does ERISA Apply to Your Employee Benefit Plans?” in the October 2003 issue of *Indian Gaming* and our earlier tribal client memos for a discussion of the applicability of ERISA to tribes and tribal entities.

² In our experience, most tribal retirement plans allow employees to invest in several mutual funds selected by the tribe. If, however, an independent fiduciary (other than the tribe or tribal entity) selects or manages the mutual funds in the retirement plan, then the tribe’s fiduciary responsibility may be less onerous.

U.S. Department of Labor Guidance

The Department of Labor has the responsibility for oversight of retirement plans governed by ERISA. In response to the investigations, the DOL has issued a few statements on how fiduciaries should respond to the investigations. The most recent statement provides the following guidance:

- **Review of investment options.** Fiduciaries should ascertain each mutual fund's practices with respect to market timing, consider the economic impact (if any) on the fund, and determine whether procedures and safeguards are in place to limit abuses.
- **Response to investigation.** If a fund is under investigation, the plan's fiduciaries must determine the economic impact on the fund and what remedial steps (if any) should be taken.
- **Request for information.** Fiduciaries should consider directly contacting the funds to obtain information on whether the funds are under investigation, and on the funds' procedures and practices regarding market timing.

The statement's bottom line – "Plan fiduciaries should follow prudent plan procedures relating to investment decisions and document their decisions. The guiding principle for fiduciaries should be to ensure that appropriate efforts are being made to act reasonably, prudently and solely in the interests of participants and beneficiaries." Although retirement plans maintained by tribes and tribal entities may not be subject to ERISA, these statements provide guidance that may be used by all fiduciaries to address the investigations.

What is Next?

Several commentators have indicated that although trading abuses may have reduced rates of return received by employees in retirement plans, the reduction is small compared to the effect of high fees charged by funds. This issue has drawn the attention of Congress and has been addressed in at least one settlement reached in the investigations. Tribes and tribal entities may wish to review the fees charged by the funds offered in their plans to verify that they are reasonable in light of the rates of return by the funds.

Conclusion

Tribes and tribal entities with fiduciary responsibility for the selection of mutual funds in their retirement plans should constantly review the funds and determine whether any are currently under investigation or are otherwise no longer suitable for their plans. The most recent DOL statement mentioned above is available at: <http://www.dol.gov/ebsa/pdf/sp021704.pdf>. An accompanying press release is available at: <http://www.dol.gov/ebsa/pdf/pr021704.pdf>. If you have a question regarding the mutual fund investigations or the review of mutual funds offered in your retirement plan, please contact the attorney you work with or call us at (612) 340-2825 (Tim Goodman) or (612) 340-8788 (Bob Burns).

Dorsey & Whitney LLP is a limited liability partnership engaged in the practice of law. This update is not intended as, and does not constitute, either legal advice or a solicitation of any particular prospective client. An attorney-client relationship with Dorsey & Whitney LLP is not formed by this update; such a relationship may be formed only by specific and explicit agreement with an individual partner of Dorsey & Whitney LLP.
