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ERISA EXPERT CALLS REIT STOCKS "A POTENTIALLY POWERFUL TOOL" IN REDUCING 401(K) FIDUCIARY RISK

Washington, D.C. — REITs' low correlation with other stocks and bonds makes them "a potentially powerful tool" for the 401(k) plan fiduciary in selecting investment options, according to a newly-published article by noted Employment Retirement Income Security Act (ERISA) attorney Evan Miller.

ERISA, the 1974 federal law that guides private-sector pension plan management, requires fiduciaries – persons with the authority to make decisions regarding a plan's assets – to invest prudently and to diversify the investments of a pension plan so as to lessen the risk of large losses.

Writing in the Fall 2002 issue of *The Journal of Pension Planning and Compliance*, Miller notes that the global bear market has caused a spate of recent ERISA class action litigation brought by 401(k) participants challenging the appropriateness of specific 401(k) investments. As these 401(k) plan class actions proceed, it is Miller's view that courts should apply modern portfolio theory concepts – especially principals of covariance – to scrutinize 401(k) plan fiduciary conduct.

In this regard, if an employer is faced with significant losses in a 401(k) investment option, its legal position would be strengthened if it can argue that the plan chose all investment options, including the challenged one, based upon a process that relied on the concepts of low correlation and diversification among all asset classes, and that the plan clearly informed participants of the importance of low correlation and diversification benefits of the various investment choices. "This is where REIT security investing can play a significant role in boosting fiduciary prudence," he writes.

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Miller's article, "Real Estate Stocks, Correlation and the ERISA Prudence Rule," observes that "the low correlative impact of REITs vis-à-vis other publicly traded equity and debt, without the 'lumpy' features of traditional real estate, makes it a particularly attractive asset class for defined benefit and 401(k) plans."

REITs also have advantages over other types of less traditional 401(k) investments, such as high yield bonds, international bond funds and hedge funds, in Miller's view. "Real estate is an investment that is far easier to understand and exists in every 401(k) participant's hometown," he writes. "REITs provide easy, low cost access to the diversification benefits of real estate and thus have significant practical and economic advantages over many of these other portfolio diversifiers."

"From a legal perspective, [REITs'] inclusion in pension portfolios or 401(k) plan option sets should significantly bolster the fiduciary's prudence position," Miller observes.

"Mr. Miller's article has great significance to all defined contribution plan sponsors and providers," remarked Michael R. Grupe, NAREIT's Senior Vice President of Research and Investment Affairs. "Because of the low correlation of REIT stock returns with the returns to other equities and bonds, the inclusion of REITs can help to reduce a fiduciary's legal exposure that a 401(k) plan's investments are either too volatile or too risky. This is valuable guidance that should be embraced by every 401(k) plan manager."

Miller is a partner in the Washington, D.C. office of Hogan & Hartson, L.L.P., where he specializes in counseling and litigation matters involving the conduct of ERISA-regulated fiduciaries. In 1998, he was named by *The National Law Journal* as one of the top 40 benefits lawyers in the United States.

Published quarterly, *The Journal of Pension Planning and Compliance* is a leading source for in-depth coverage of pension compliance and design issues.

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