Fiduciary Responsibility of Retirement Board Members and Staff
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FIDUCIARY RESPONSIBILITY OF RETIREMENT BOARD MEMBERS AND STAFF

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Fiduciary Responsibility

• What makes a person a fiduciary?

• What are the special duties of fiduciaries?

• To whom do fiduciaries owe a duty?
What makes a person a fiduciary?

- Actual exercise of discretion and control over plan assets.
  - Investments.
  - Purchasing decisions for goods and services.
- Failure to be involved or to take discretionary actions does not change status as fiduciary.
  - Can be liable even though disengaged.
  - Cannot delegate away fiduciary status.
  - Even if delegate activities, still a fiduciary.
- What is fiduciary insurance?
  - Can protect the fund from wrongful acts of fiduciaries, but does not necessarily protect the fiduciaries from their own actions (can purchase separate personal insurance but query whether the plan can pay for this).
- Insurance may not necessarily pay for losses or restore money to the fund.
- If fiduciaries are acting in the scope of their responsibility, the retirement system can pay for lawyers.

What are the special duties of fiduciaries?

- Loyalty
  - Not just honesty but the highest standard of loyalty.
- Prudence
- Monitor the activities of employees and advisors.
- Impartiality - fairness to all members and beneficiaries.
  - No favoritism
- Avoid Conflicts.
- Comply with retirement laws and regulations and other applicable laws.
- Expend system assets reasonably and properly.
- Collect contributions timely and correctly.
- Hire and monitor competent staff and necessary experts/specialists.
To whom do fiduciaries owe a duty?

- Duty owed *solely* to the members and beneficiaries of the system.
  - This means current and future beneficiaries.
  - Retirement plans usually act with a 30+ year horizon.
- Board members are not representatives of the interests of others.
  - Not the people who elected them or appointed them.
  - Not the “taxpayers”.
  - Social and political agendas must mesh with the duty to act for the sole interest of the members and beneficiaries.

Fiduciary Responsibility

- What standard must a fiduciary meet?
- What does a fiduciary have to do to meet this standard?
- What activities or relationships are prohibited?
- What are co-fiduciaries and what responsibility does one have for the acts of another?
What standard must a fiduciary meet?

- Loyalty: Must exercise the highest and undivided loyalty to the trust.

- Prudence: Must exercise the skill, care, prudence and diligence under the current circumstances that a prudent person acting in a like capacity and familiarity with such matters would use in the conduct of an enterprise of like character and with like aims - “the prudent expert”.

What does a fiduciary have to do to meet this standard?

- Hire competent and qualified staff and experts.
- Be vigilant and have strong awareness.
  - Monitor employees, consultants, managers.
- Become and remain knowledgeable.
  - Take advantage of education and training opportunities.
- Establish and follow processes and procedures for decision making.
  - Records, policies, and regulations.
- Be aware of and prudent about expenditures.
What activities or relationships are prohibited?

- Receiving a payment or anything of value for acting as a fiduciary.
- This is why fiduciaries are often reimbursed for expenses rather than compensated.
  - Compensation allowed under G.L. c. 32, § 20.
- Dealing with the assets of the board for personal gain or profit.
- Acting on behalf of someone other than the members or beneficiaries.
- Causing or allowing the retirement system to engage in a prohibited transaction.

What are co-fiduciaries and what responsibility does one have for the acts of another?

- Co-fiduciaries are other plan fiduciaries, board members, staff, and advisors.
- A co-fiduciary who knows of another fiduciary’s breach of duty and fails to try to prevent this breach can be held liable for losses.
  - Exception: You have to know of the breach.
    - Exception to the Exception: Should you have reasonably known of the breach? Remember the duty to be informed and involved.
- Failure to monitor co-fiduciaries may be a breach of fiduciary duty.
- Duty to try to prevent breach.
  - Resignation not enough.
- Must take steps: Legal action.
Conflict of Interest

- State Laws
  - G.L. c. 268A is applicable to fiduciaries (840 CMR 17.03).
- PERAC Regulations
  - 840 CMR 17.00
- Federal Laws
  - ERISA sets out responsibilities for fiduciaries in private sector plans. Even though it does not apply to Chapter 32 plans, the concepts are general trust law and could be applied in litigation.
  - Common law fiduciary responsibility.
  - ERISA deals with pension plans and is likely to be applied, especially because the language is similar.
  - ERISA has been in effect for nearly 25 years, so it is a good guide as to how fiduciaries should act and how courts will expect fiduciaries to act.

Conflict of Interest

- State Ethics Commission
- Public officials and public employees are held to a very high standard.
- Conflict v. Appearance of conflict
  - Recusal in conflict situations
  - Rule of necessity
- On-the-job restrictions and prohibitions
- Off-the-job restrictions and prohibitions
State Ethics Commission

- The non-partisan Commission consists of five members appointed to staggered, five-year terms:
  - 3 selected by the Governor
  - 1 by the Secretary of State
  - 1 by the Attorney General
- The Commission staff is made up of four separate divisions, under the supervision of the executive director.
  - The Legal Division provides free, confidential advice to public employees regarding the legality of proposed activities.
  - The Statements of Financial Interests Division administers the financial disclosure law.
  - The Public Education Division conducts free seminars for public employees and publishes educational materials.
  - The Enforcement Division investigates and prosecutes alleged violations of the laws.

Public officials and public employees are held to a very high standard.

- The Ethics Commission has ruled that the conflicts law applies to retirement board members. Board staff would be subject to the law as well, because they are public employees.
- Anyone who is covered by the conflict of interest law may request free, confidential legal advice about how the law applies to oneself in a particular situation.
- To request such an opinion, either call the Ethics Commission's "lawyer-of-the-day" or write a letter, include all the relevant facts, addressed to the commission.
Conflict v. Appearance of Conflict

• Recusal in Conflict Situations
  • If a member of the Board has an actual conflict, refrain from acting on that particular matter.
  • Do not participate in the discussion. Leave room if appropriate. Do not influence other board members. Do not vote.

Rule of Necessity

• The Rule of Necessity may only be used when a board is legally required to act on a matter and it lacks enough members to take valid official action solely due to board members being disqualified by conflicts of interest from participating in the matter.
  • If no majority of the board exists because of conflicts, the board may invoke the "rule of necessity" only as a last resort.
    • Board member must disclose conflict and explain circumstances. Must be reflected in minutes.
  • Appearance of a conflict may be as damaging to the Board as a real conflict and should be avoided.
  • Fiduciaries are to instill trust and respect – “the smell test”.
On-The-Job Restrictions and Prohibitions

• Seeking or taking bribes.
  • Anyone offering a bribe is also guilty of a violation.
  • "Bribe" anything of value (not necessarily monetary in nature) in exchange for taking an official action or performing an official duty.
• Soliciting a gift of substantial value ($50) from one who may come before board.
• Refrain from acting on matters where there is a personal gain.

Off-The-Job Restrictions and Prohibitions

• General prohibition of holding more than one position (not necessarily applicable because of statutory composition of board).
• Outside activities that directly relate to duty on the board.