

# **FIDUCIARY RESPONSIBILITY OF RETIREMENT BOARD MEMBERS AND STAFF**



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# 840 CMR 1.01

“A board member shall discharge all of his/her duties solely in the interest of members and their beneficiaries, and

- 1) For the exclusive purpose of:
  - a) providing benefits to members and their beneficiaries; and
  - b) defraying reasonable expenses of administering the system.
- 2) With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.
- 3) By diversifying the investments of the system so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
- 4) In accordance with the Massachusetts General Laws, the rules and regulations promulgated by the Commission, and rules and regulations adopted by the Board and approved by the Commission.”

# 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

# Fiduciary Insurance

- ▶ 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 *(Continued)*

- ▶ 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.

# ESG v. Investment Performance

- ▶ Environmental, Social and Governance Goals
  - Fossil Fuel divestment, wage equality, workforce diversity, customer and employee satisfaction

# “Fulfilling a Valuable Purpose”

- ▶ “The work of fiduciaries to secure retirement income through their oversight of the investment of assets is an underappreciated objective and often unmet challenge. Fulfilling the security of pension benefits serves an important purpose to the society and economy. Fulfilling that mission leaves the society and economy with resources that might otherwise have gone to support retirees for use of other priorities. Fiduciaries should never lose sight of their high calling on behalf of participants.”  
*See Fulfilling a valuable purpose, Pensions and Investments, April 6, 2015.*

# Actions to Take Before Authorizing New Investment

- ▶ Evaluate investment, historical returns, risks and potential returns
- ▶ Find reliable market price of investment, if none, independent valuation required

# Delegation to a Consultant

- ▶ Understand manager's track record
- ▶ Potential conflicts of Interest
- ▶ Ensure compensation paid is reasonable for value of services
- ▶ "Due Diligence"



# Actions to Take After an Investment is Made

- ▶ Returns are down or market has shifted
  - Obligation to re-evaluate to whether to retain, modify or liquidate the investment
- ▶ Change in ownership involving manager
  - Obligation to investigate retaining the manager
- ▶ New Conflict of Interest
  - Determine if the conflict is real

# ***Tibble v. Edison***

**No. 13-550, U.S. Supreme Court, May 18, 2015**

- ▶ The U.S. Supreme Court has rendered a unanimous opinion in the *Tibble* case involving ERISA's six-year statute of limitations for fiduciary violations.
- ▶ The alleged violation involves the nature of the investment itself, specifically retail-class mutual funds that are usually, but not always, more expensive than comparable institutional-class funds.

## ***Tibble v. Edison*** (Continued)

**No. 13-550, U.S. Supreme Court, May 18, 2015**

- ▶ Plan fiduciaries in Tibble selected three retail-class funds as plan investment options in 1999, more than six years before plan participants filed a lawsuit claiming this was imprudent.

## ***Tibble v. Edison*** (Continued)

**No. 13-550, U.S. Supreme Court, May 18, 2015**

- ▶ In a brief opinion by Justice Breyer, the Supreme Court found that plan fiduciaries are required to conduct regular reviews of plan investments.
- ▶ As applied to ERISA fiduciaries, there is nothing new in the proposition that fiduciaries have a continuing duty to monitor investments.

## ***Tibble v. Edison*** (Continued)

**No. 13-550, U.S. Supreme Court, May 18, 2015**

- ▶ New ground broken by the Tibble decision is to be found in the Supreme Court's view that the nature and timing of this review are contingent on the circumstances.
- ▶ The case was remanded to the Ninth Circuit to determine how often and how deep fiduciaries must look at plan investments in order to satisfy their monitoring duty.

## ***Tibble v. Edison*** (Continued)

**No. 13-550, U.S. Supreme Court, May 18, 2015**

- ▶ While the level and intensity of review subsequent to initial selection required to avoid a fiduciary breach is yet to be determined, the Tibble decision is a clear victory for plaintiffs, because the Supreme Court has confirmed that the six-year statute of limitations is not an absolute bar to a legal action for fiduciary breach with respect to the selection of investment options.

# Imprudent Past Decisions

- ▶ A new fiduciary has a duty to look into prior bad decisions made by co-fiduciaries
- ▶ Obligation to investigate and rectify proper breaches

# Questions to Ask

- ▶ Is the Investment firm registered with the SEC or the State?
- ▶ Have you asked the investment firm for a copy of its last deficiency letter with the SEC?
- ▶ Is the investment firm reputable?
- ▶ Is the investment firm in any lawsuits?
- ▶ Has the investment firm followed the PERAC placement agent policy?
- ▶ Does the investment firm receive bad press?
- ▶ Have you voiced any of these concerns with PERAC?