

# A Simple Guide to the Fiduciary Responsibilities of Public Pension Plans

Pennsylvania Association of Public Employee Retirement Systems  
14th Annual Forum  
May 22, 2018

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# Outline

- Brief overview of PA Pension system and relevant laws
- Definition of Fiduciary
- Four types of fiduciary duties
  - Duty of Loyalty
  - Duty of Care
  - Duty to Diversify
  - Duty to Follow Plan Documents
- Best Practices
- Questions?

# PA Pensions

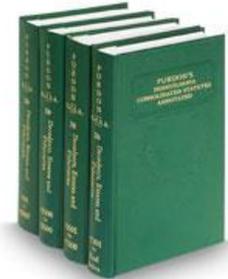
- Approximately 3,200 municipal pension plans (Both DB and DC)
  - *Pennsylvania State Employees' Retirement System (SERS)*
  - *Public School Employees' Retirement System (PSERS)*
  - *City pension plans (Philadelphia, Pittsburgh, Scranton, etc.)*
  - *Municipal pension plans*
  - *County pension plans*
    - Home rule plans
    - Pennsylvania Municipal Retirement System

# ERISA

- Employee Retirement Income Security Act of 1974 (ERISA)
  - *29 USCA § 1001*
  - *Federal law*
  - *Does not govern governmental pensions BUT....*
- Most states have adopted fiduciary standard similar to ERISA and many state courts borrow and cite to ERISA decisions in applying fiduciary rules

# Relevant PA Laws

- **20 Pa.C.S. § 7301** – *Municipalities*
  - Definition of Fiduciary
- **24 Pa.C.S. § 8502** - *PSERS*
  - Administrative duties of the board
- **53 P.S. § 881.110** – PA Mun. Ret. System
  - Board members are fiduciaries
- **16 Pa. Stat. Ann. § 11654 and § 11659**– *County Retirement Boards*
  - General duties
- **20 Pa. C.S.A. § 7701**- PA Uniform Trust Act
  - Health and Welfare Funds/ “Express Trusts”



# Are you a Fiduciary?

- “The Commission has identified the lack of a fiduciary responsibility and liability standard for thousands of local government employee retirement systems in Pennsylvania as a significant deficiency...”
- “Currently Pennsylvania law fails to define who has a fiduciary relationship with the retirement system and leaves a void with respect to the regulation of a potentially significant portion of fiduciary behavior and activity.”
  - *1989 study by the Public Employee Retirement Commission*
- Lack of uniformity creates problems

# Are you a Fiduciary?

- ERISA
  - *Anyone who exercises discretionary control or authority over plan management or plan assets; OR*
  - *Anyone with discretionary authority or responsibility for the administration of a plan; OR*
  - *Anyone who provides investment advice to a plan for compensation or has any authority or responsibility to do*
- 20 Pa.C.S.A. § 7301
  - *The term “**fiduciary**” as used in this chapter shall include an administrator of a municipal pension or retirement plan and any other person whose fiduciary duties are, by statute, governed by the principles of this chapter.*
- 53 P.S. § 881.110 – PA Municipal Retirement System
  - The members of the board shall be trustees of the fund, and shall have the exclusive management of said fund, with full power to invest the moneys therein, subject to the terms, conditions, limitations and restrictions imposed by law upon **fiduciaries**.



# Are you a Fiduciary?

- Look at Plan and/or Trust Documents
  - *Do they define “fiduciary”?*
  - *Do they specify who is or is not a fiduciary based on actions (discretion, investment, etc...) or by position (Trustee, investment advisor, administrator)*
  - *What are the duties?*

# Are you a Fiduciary?

IF YOU ARE:

- Board Member
- Trustee
- Delegated Fiduciary

THEN YES

# Are you a Fiduciary?

IF YOU ARE:

- Administrator
- Investment Manager/Investment Advisor
- Insurer

Look at contract language and responsibilities.

- Exercise control and discretion over plan assets?
- Make decisions regarding benefits or claims?
- Fiduciary only as to fiduciary actions – Eg. Ministerial tasks

New DOL Rule



# Fiduciary Standards of Conduct

## ■ Four Key Requirements

1. *Duty of Loyalty (the “Exclusive Benefit Rule”)*
2. *Duty of Care (the “Prudent Person Rule”)*
3. *Duty to Diversify Plan Investments*
4. *Duty to Follow Plan Documents*



# Duty of Loyalty/Exclusive Benefit

A fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries for the exclusive purpose of:

- i. Providing benefits to participants and their beneficiaries; and
- ii. Defraying reasonable expenses necessary to administering the plan.



# Duty of Loyalty/Exclusive Benefit

A fiduciary cannot:

- Deal with the assets of the plan for his own interest or for his own account;
- Act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries; and
- Receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.



# Duty of Care/Prudent Man Rule

## ERISA:

### *Fiduciary must act:*

- with the care, skill, prudence, and diligence
- that a prudent person
- acting in a like capacity and familiar with such matters
- would use in similar circumstances



# Duty of Care/Prudent Man Rule

**DO YOUR HOMEWORK**

**MIND THE STORE**





# Do Your Homework

- Know the laws specific to your fund
  - *For example, Act 600 of 1956, which governs many municipal police pension plans. This act allows the employee contributions to be reduced or eliminated merely through the passage of an annual municipal ordinance or resolution.*
- Know your funding source.
  - *How stable is it?*
- Talk to your attorney



# Do Your Homework

- Know your assumptions
  - 7%? 8%?
  - *Investments that are very difficult to achieve over multiple years (e.g. over 200 plans are still using an 8 percent projected return). The use of an unrealistic rate of return camouflages how much a pension plan is truly underfunded because it masks the size of the problem when funding projections are based on inflated returns.*



# Mind The Store

- Vendors
  - *Attorney, Accountant, Actuary, Investment advisor, etc...*
  - *Requests for proposals*
  - *Know what questions to ask*
  - *What are you paying?*
  - *Contract provisions?*
    - Hidden fees
    - Termination
    - Indemnification/Insurance



# Duty of Care/Prudent Man Rule

- Process is key to demonstrating prudence
  - *Carefully select expert advisers*
    - Due diligence on qualifications is important
  - *Consider the benefits. . . but also the risks*
- **MINUTES**
  - *Even a procedurally prudent fiduciary could have a problem if the decision made does not meet the standard from a substantive perspective*



# Duty of Care/Prudent Man Rule

## ■ Rule of Thumb



If you were called to a witness stand to testify as to your decision, would you be able to testify in a way that showed you understood what you were doing and why the benefits outweighed the risks?

# Duty to Diversify/Investments

## **20 Pa.C.S.A. § 7302**

- *Any investment shall be an authorized investment if a purchased or retained in the exercise of that degree of judgement and care, under the circumstance then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income to be derived therefrom as well as the probable safety of their capital.*



# Investments

- Duty to Diversify Plan Investments
  - *Must diversify, unless imprudent to do so, to protect against large losses*
    - Investment consultant assists with asset allocation
  - *Considerations include:*
    - Plan's portfolio as a whole and plan's purpose
    - Risk of loss and opportunity for gain (risk/return analysis)
    - Liquidity and portfolio return vs. cash flow needs
    - Projected return relative to funding objectives
  - *Are you shooting for the moon? Do you need to?*



Note: Bitcoin is not a prudent Pension Fund investment

# Investments

- Adopt a written investment policy statement that includes the investment philosophy of the pension plan as well as the risk and return objectives.
  - Work with your investment advisor and actuary
  - You need to understand your funding levels and potential funding issues when setting your allocations
  - Know what others plans are doing but focus on your plan's specific goals



# Investments

- Duty to monitor your investments
  - You’ve done all of the legwork but you can’t set it and forget it.
  - Educate yourself
  - Actuarial outlook
  - Funding outlook
  - Meet with managers
  - Minutes!! – If a tree falls...



# Duty to Follow Plan Documents

- Plan documents are applicable statutes (state, federal and ordinances), regulations, pension plan agreement policies and investment parameters
- Administer/pay benefits according to plan document
  - *Different ways to get tripped up (eligibility, benefit, criminal issues, etc...)*
- Minimizing risk
  - *Proper plan language*
  - *Consistent interpretation*
- Seek opinions from legal counsel to address ambiguities



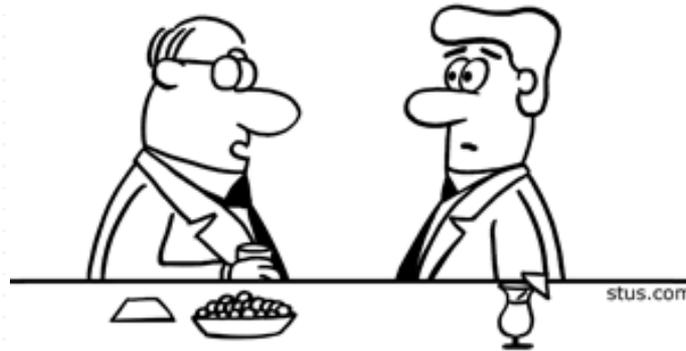
# Duty to Follow Plan Documents

- Appeals
- Amending the Plan
  - *Get a written opinion from counsel*
- Policies:
  - *Investment*
  - *Trustee expenses*
  - *Conflict of interest*
  - *QDRO*



# Liability

- Everywhere
- The San Diego City Attorney sued the trustees of the San Diego Employee Retirement System (SDCERS) for violating California conflict of interest laws.
- A class action was filed against the trustees of the Detroit pension plans for allegedly causing the funding gap with imprudent investments.
- Dozens of other suits in other states



This "fiduciary" thingy really complicates pillaging a corporation.

# Liability

- Breach of Fiduciary Duty
  - *Potter v. Springfield Twp.*, 681 A.2d 241 (Pa. Commw. Ct. 1996) – Administrator stole money
  - *Flood v. Makowski*, No. CIV.A. 3:CV-03-1803, 2004 WL 1908221, at \*1 (M.D. Pa. Aug. 24, 2004) – **Co-Fiduciary** for accepting campaign contributions
- Benefit denial cases
  - *McCarrell v. Cumberland Cty. Employees Ret. Bd.*, 120 Pa. Cmwlt. 94, 547 A.2d 1293 (1988) – Cost of living increases
  - *George C. PAPPAS, Appellee, v. CITY OF LEBANON, et al*, 2005 WL 5167485 (Pa.Cmwlt.), - Vesting issue
- Seek statutory indemnity



# Fiduciary Liability Insurance

- Do you trust your statutory indemnity?
- Look at a **Fiduciary insurance policy**:
  - *Covers the plan*
  - *Non-Recourse rider – Covers Trustees; must be paid for by Trustees individually. Cannot be paid by plan.*



# Takeaways

- Know your plan documents
- Familiarize yourself with the law
- Review your professionals (actuary, investment advisor, attorney, etc...)
  - *RFPs every 3-5 years*
- Draft policies with help from advisors
- Monitor EVERYTHING
- Take detailed minutes



QUESTIONS?

