Fiduciary Principles to Guide Public Retirement System Trustees

CalPERS Board of Administration Fiduciary Training

Ashley K. Dunning
Partner, Co-Chair of Public Pensions & Investments Group

January 21, 2020

Board of Administration Educational Day
JANUARY 2020

CalPERS

What is a Fiduciary Relationship?

- A fiduciary relationship is one of trust and confidence which, in the words of Justice Benjamin Nathan Cardozo (US Supreme Court Justice from 1932 to 1938) is "something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."
  - *Meinhard v. Salmon*, 249 N.Y. 458, 464 (Ct. App. 1928)

Who is a Fiduciary?

- Fiduciary relationships exist between agents and principals, wards and guardians, customers and banks, clients and attorneys, patients and doctors, partners and partners, shareholders and directors, and trustees and beneficiaries of trusts.

Why Does it Matter Whether One is a Fiduciary?

- In fiduciary relationships, the law demands a higher than ordinary degree of care and responsibility from the dominant or trusted party.

What Do Courts Say About Fiduciary Duties?

- The 9th Circuit has noted with respect to fiduciary responsibilities that "These duties are the highest known to the law."
  - *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996), cert. denied, 520 U.S. 1237 (internal quotation marks omitted) ("*Howard*").

The Two Prongs of Fiduciary Duties

- Duty of care
- Duty of loyalty

Fiduciary Duty of Care

- Prudent Expert Rule
  - "The members of the retirement board . . . shall discharge their duties with respect to the system with the *care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.*"
    - Cal. Const., art. XVI, § 17(c) (emphasis added).

Fiduciary Duty of Care

- Prudent Expert Rule
  - "As an initial guideline, a trustee 'has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law.'"
    - *O'Neal v. Stanislaus County Employees' Retirement Assoc*. (2017) 8 Cal.App. 5th 1184, 1209 ("*O'Neal*") [quoting Rest. 3d Trusts, §76, accord, Prob. Code, §16000]"

Fiduciary Duty of Care: the "Prudent Expert"

- Skill required of trustees
  - The Prudent Investor Rule standards
    - "require fiduciaries possessing special facilities and skills to make those advantages available to the trust and its beneficiaries."
    - Restatement 3d Trusts, sec. 227, Cmt. *d*.
  - Standard is *objective*, not subjective to the trustee.
    - Private pension trustees may not escape the "reasonable person" standard of prudence in making investments by having a "pure heart and an empty head". *Donovan v. Cunningham* (716 F.2d 1455, 1467 (5th Cir. 1983)).

Fiduciary Duty of Care: the “Prudent Expert”

- Skill required of trustees
  - The “prudence standard is ‘not that of a prudent lay person, but rather that of a prudent fiduciary with experience dealing with a similar enterprise’.” *Whitfield v. Cohen*, 682 F. Supp. 188, 194 (S.D.N.Y. 1998) (quoting *Marshall v. Snyder*, 1 Empl.Ben. Cases (BNA) 1878, 1886 (E.D.N.Y. 1979)).
  - Courts may probe the thoroughness of a fiduciary’s analysis and basis for its decisions, rather than simply deferring to a determination that a fiduciary may make. See *Howard, supra*, 100 F.3d at p. 1488.

Fiduciary Duty of Care:
the "Prudent Expert"

- Skill required of trustees
  - In *Howard*, the court scrutinized an Employee Stock Ownership Plan (ESOP) that plaintiffs challenged and concluded self-interested fiduciaries of an ERISA plan may not blindly rely on an appraisal of the ESOP provided by a Big Eight accounting firm, but rather they must be certain – particularly in the context of their own self-interest in the transaction – that such reliance is reasonable.
    - *Howard, supra*, 100 F.3d at p. 1488.

Fiduciary Duty of Care: Actuarial Services and "Competency" of Assets

- Duty to Assure Competency of Retirement System Assets
  - "The retirement board of a retirement system… consistent with the exclusive fiduciary responsibilities vested in it, shall have the *sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the…retirement system*."
    - Cal. Const., art. XVI, § 17(e) (emphasis added).

Fiduciary Duty of Care: Actuarial Services and "Competency" of Assets

- In *O'Neal*, petitioners challenged various board of retirement decisions relating to the actuarial methodologies and transfers of funds among reserves authorized by the board of retirement.
  - *O'Neal, supra*, 8 Cal.App. 5th at p. 1209.

Fiduciary Duty of Care: Actuarial Services and “Competency” of Assets: *O’Neal*

- The court in *O’Neal* described the 1992 ballot initiative known as Proposition 162, which was passed “in apparent response to fears that the Legislature was raiding pension funds to balance their budget.” *Id*. at p. 1203.
- *O’Neal* then noted “Proposition 162 moved control of pension funds and actuarial services from the Legislature to pension systems by ensuring retirement boards shall have ‘sole and exclusive fiduciary responsibility [1] over the assets of the…retirement system’ and…[2] to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries.” *Id*. at p. 1203.

Fiduciary Duty of Care: Actuarial Services and "Competency" of Assets: *O'Neal* (cont.)

- *O'Neal* concluded that the retirement board had not violated its fiduciary duty of care by making certain actuarial decisions that resulted in lowering the employer contribution rate (such as permitting negative amortization), though it deferred a final decision on that topic with respect to the alleged breach of the duty of loyalty (discussed further below).
  - *O'Neal*, *supra*, 8 Cal. App. 5th at p. 1221, n. 10.

Fiduciary Duty of Care: Actuarial Services and "Competency" of Assets: *Mijares*

- Another recent California court of appeal decision on actuarial authority of board of retirement: *Mijares v. Orange County Employees' Retirement System* (2019) 32 Cal.App.5th 316 ("*Mijares*")
- Facts of *Mijares*: Orange County Department of Education (OCDE) and School Superintendent Mijares filed a complaint for declaratory relief against OCERS challenging the Board of Retirement's decision to charge OCDE for a portion of OCERS' UAAL after the OCDE's last employee filed for retirement, and thus no active members remained with the retirement system.

Fiduciary Duty of Care: Actuarial Services and “Competency” of Assets: *Mijares*

- Court of Appeal upheld OCERS’ new policy applicable to employers with declining or no employee payroll:
  - Unfunded actuarial liabilities are not “payable debts” that OCERS imposed on employer retroactively.
  - County Employees Retirement Law of 1937 (CERL) requires participating plan employers to make contributions to pay unfunded actuarial liabilities regardless of whether the employer has only retired members in the plan and regardless of whether the contribution is calculated as a percentage of payroll or a lump-sum payment.
  - California Constitution gives retirement boards broad authority to take needed measures to assure adequate funding for retirement benefits.

Fiduciary Duty of Care: Duty to Monitor

- The duty to monitor and to take corrective action when reasonably appropriate is fundamental to a trustee's exercise of the duty of care. Rest. 3d Trusts, § 227, p. 14 (1992), comment d ("The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives").

Fiduciary Duty of Care: Duty to Monitor (cont.)

- In 2015, the United States Supreme Court addressed this topic in *Tibble v. Edison International*, 575 U.S. ____, 135 S. Ct. 1823, 191 L. Ed. 2d 795 (May 18, 2015) (“*Tibble I*”):
  - In this case, Petitioners contended that fiduciaries of an ERISA defined-contribution plan acted imprudently in offering higher priced retail-class mutual funds to them, when the fiduciaries allegedly could have offered effectively the same mutual funds to them at the lower price available to institutional investors such as the plan.
  - The lower price reportedly reflected the lower administrative costs afforded to institutional investors.

Fiduciary Duty of Care: Duty to Monitor, *Tibble*

- *Tibble I* observed:
  - Under the common law of trusts, a fiduciary is required to conduct a regular review of its investments with the nature and timing of the review contingent on the circumstances.
  - Under trust law, a trustee also has a “continuing duty to monitor trust investments and remove imprudent ones.”
  - A fiduciary’s alleged “imprudent retention of an investment” could provide the basis of an action that would trigger the running of a limitations period, not simply the original investment date.

Fiduciary Duty of Care:
Duty to Monitor, *Tibble*

- *Tibble I* remanded the case for consideration by the 9th Circuit and did not decide in this instance:
  - Whether the challenged mutual funds' investment fee structure as compared to analogous investment opportunities constituted a breach of fiduciary duty by the trustees who failed to remove the more expensive, but otherwise equivalent, investment options from the mutual funds proposed to members of the plan.

Fiduciary Duty of Care: Duty to Monitor, *Tibble*

- On remand from the Supreme Court, the en banc 9th Circuit vacated the district court's judgment in favor of the plan sponsor and its benefits plan administrator on claims of breach of fiduciary duty in the selection and retention of certain mutual funds for a benefit plan governed by ERISA.
  - *Tibble v. Edison Int'l*, 843 F.3d 1187, 1198 (9th Circ. 2016) ("Tibble II")

Fiduciary Duty of Care: Duty to Monitor, *Tibble*

- The 9th Circuit observed:
  - "In fulfilling his duties, a trustee is held to 'the prudent investor rule,' which requires that he 'invest and manage trust assets as a prudent investor would'; that is, by 'exercis[ing] reasonable care, skill, and caution,' and by 'reevaluat[ing] the trust's investments periodically as conditions change.'" *Tibble II, supra*, at p. 1197 [quoting A. Hess, G. Bogert & G. Bogert, Law of Trusts and Trustees § 684, 145-46 (3d ed. 2009) [hereinafter Bogert 3d]) Bogert 3d § 684.]

Fiduciary Duty of Care:
Duty to Monitor, *Tibble*

- *Tibble II* also observed:
  - “pursuant to the Restatement (Third) of Trusts, a trustee is to ‘incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship.’" [Rest. 3d Trusts, § 90(c)(3); *see also id*. § 88.] The Restatement further instructs that "cost-conscious management is fundamental to prudence in the investment function,” and should be applied “not only in making investments but also in monitoring and reviewing investments.” *Id*. § 90, cmt. b; *see also id*. § 88, cmt. a.
    - Tibble II, supra, at pp. 1197-1198.

Fiduciary Duty of Care: Duty to Monitor, *Tibble* (cont.)

- *Tibble II* vacated the district court's decisions regarding applicability of a statute of limitations regarding challenges to mutual funds added to the Plan before 2001.
- The 9th Circuit then remanded for trial on the claim that, "regardless of whether there was a significant change in circumstance, [the Plan Sponsor] should have switched from retail-class fund shares to institutional-class fund shares to fulfill its continuing duty to monitor the appropriateness of trust investments."
  – *Tibble II*, *supra*, at p. 1198.

Fiduciary Duty of Care:
Duty to Monitor, *Tibble*

- Conclusion:
  - On August 16, 2018, the U.S.D.C., Central District of California Court of Appeal issued Findings of Fact and Conclusions of Law in favor of plaintiffs. (CV 07-5359 SVW (AGRx)) ("*Tibble III*")
  - Court in *Tibble III* held Defendants liable for breaching their fiduciary duties of care and loyalty, beginning six years prior to the date the action was filed (based on 6 year statute of limitations under ERISA), by not disposing of retail share classes *immediately* after institutional share classes were made available.

Fiduciary Duty of Care: Duty to Monitor, *Tibble*

- The court in *Tibble III* explained:
  - "The Court does not suggest that in all duty to monitor cases a fiduciary would breach their duty the day a fund becomes imprudent. Certainly, reasonable fiduciaries are not expected to take a daily accounting of all investments, and thus the reasonable discovery of an imprudent investment may not occur until the systematic consideration of all investments at some regular interval. [Citing *Tibble I* at 1828.] However, the facts of this particular case present an extreme situation. Defendants have never disputed that a reasonable fiduciary would be knowledgeable of the existence of the institutional shares for the mutual funds at issue. Thus, there is no credible argument that a reasonable fiduciary only would have discovered these share classes during some later annual review. Defendants always knew, or should have known, institutional share classes existed."

Fiduciary Duty of Care:
Duty to Monitor, *Tibble* (cont.)

- *Tibble III*:
  - The District Court entered judgment in favor of the Plaintiff class, jointly and severally, in the amount of $13,161,491, and the Court denied plaintiffs' request to recover their expert witness fees.
  - Plaintiffs appealed the denial of $964,212 in expert witness fees to the 9th Circuit (Case No. 18-55974).

Retirement System Take-Aways from *Tibble*?

- Retirement systems should ensure that:
  - Some process is adopted and implemented to ensure reasonable oversight on a periodic basis of the investments made on behalf of the trust beyond the due diligence undertaken when the investment decision was originally made.

Retirement System Take-Aways from *Tibble*? (cont.)

- Monitoring process should:
  - Analyze compliance with systems' existing investment policies and contractual terms
    – Including, among other terms, diversification and leverage limits, and fee and expense allocation provisions.
  - Include a process to trigger a more focused review in some circumstances
- Exclusive reliance on self-reporting by investment managers may be insufficient.

Fiduciary Duty of Care: Diversify Investments

- Duty to Diversify Retirement System Assets
  - "The members of the retirement board of a public pension or retirement system *shall diversify* the investments of the system so as to *minimize the risk of lo*ss and to *maximize the rate of return, unless under the circumstances it is clearly not prudent to do so*."
    - Cal. Const., art. XVI, § 17(d) (emphasis added).
- Note difference of above language from ERISA language (and prior sec. 17(b) language) requiring diversification unless it is clearly "prudent not" to do so. The California diversification requirement is more rigorous than the ERISA standard.

Fiduciary Duty of Care: Divestment Mandates?

- Statutorily-provided divestment
  - “The *Legislature* may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and *provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.*”
    - Cal. Const., art. XVI, § 17(g) (emphasis added).

Fiduciary Duty of Care: Consult with Experts

- “To the extent necessary or appropriate to the making of informed investment judgments by the particular trustee, care also involves securing and considering the advice of others [such as legal, actuarial and investment counsel] on a reasonable basis.”
  - Rest. 3d Trusts, supra, § 227, p. 15, comment d.

Fiduciary Duty of Care: Consult with Experts

- The implicit corollary to the duty to consult with experts is that if a fiduciary fails to follow the advice of its professional consultants, it must demonstrate an informed, reasonable, and prudent rationale for failing to do so.
- Another implicit corollary is that expert advice from a reasonable source should provide the basis for a Board's decision to take an alternative course of action on a topic within that area of expertise (e.g., investment, actuarial, legal).

Fiduciary Duty of Care: Delegation

- “A trustee has a duty personally to perform the responsibilities of the trusteeship except as a *prudent person might delegate those responsibilities to others*. In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a *prudent person* would in act in similar circumstances.”
  - Rest. 3d Trusts, supra (Prudent Investor Rule, § 171, adopted in 1992) (emphasis added).

Fiduciary Duty of Care: Delegation

- On delegation, *Tibble III* observed at pp. 16-17 (emphasis added):
  - "In order to determine whether an investment decision is prudent, a fiduciary has a duty to investigate, and may secure independent advice from financial advisors or other experts in the course of the investigation. *Donovan v. Bierwith*, 680 F.2d 263, 272-73 (2d. Cir. 1982). **However, the fact that a fiduciary secured independent advice does not necessarily indicate that he acted prudently.** *Howard*, 100 F.2d at 1489; Bierwith, 680 F.2d at 272; *George v. Kraft Foods Global, Inc.,* 641 F.3d 786, 799 (7th Cir. 2011) (reversing grant of summary judgment for defendants on breach of prudence claim because "relying on the advice of consultants" is not a complete defense)."

Fiduciary Duty of Care: Prudent Delegation

- ***Prudence*** is the key to all aspects of delegation:
  - Whether to delegate;
  - How to delegate;
  - To whom a task is delegated; and
  - How to supervise.

Fiduciary Duty of Care: Prudent Delegation

- Uniform Prudent Investors Act:
  - A trustee may delegate investment and management function that a prudent trustee of comparable skills could properly delegate under the circumstances…" 7B Unif. Laws Ann. (2000) at 303.

Fiduciary Duty of Care: Maintenance of Retirement System Confidential Information

- As a Board member, will receive confidential information of CalPERS:
  - Confidential investment information
  - Confidential attorney-client privileged information
  - Confidential member, including health, information
- Imperative that Board members not disclose that confidential information of the Board, CalPERS or a third party, and the privilege is not that of a single Board member's to waive.

Fiduciary Duty of Care: Governance

- The Board of Administration has adopted a Governance Policy that articulates:
  - The legal authority under which the Board operates
  - Governance principles to which the Board collectively has committed
  - Responsibilities of individual Board members and of the Board
  - Roles of the Board President, Vice-President, Chairs and Vice-Chairs
  - Delegations to CalPERS executives and Board reporting relationships

Fiduciary Duty of Care: Governance Policy

- Board members' compliance with their individual fiduciary duty as trustees includes acting within the parameters of the Board's Governance Policy.
- Board members should remain familiar with the Governance Policy, and note that the Policy itself includes provisions by which the Board as a whole, and the Board President, governs Board members' compliance with the Policy through potential public or private discipline. (Governance Policy, Section V, B (2) and Section VIII, B(2), respectively.)

Fiduciary Duty of Care:
Maintaining Tax Qualified Status of CalPERS

- The Board has an obligation to prudently administers the CalPERS in a manner that maintains the federal tax qualification of the plan for the benefit of its current members and beneficiaries.

Fiduciary Duty of Care: Maintaining Tax Qualified Status of CalPERS (cont.)

- California courts have enforced retirement board decisions that were made in order to address federal tax qualification considerations. *See, e.g., San Diego City Firefighters Local 145 v. Board of Admin. of San Diego City Employees' Retirement System* (2012) 206 Cal.App.4th 594, 620 (upheld the City's retroactive repeal of certain aspects of the SDCERS retirement plan after the IRS issued a compliance statement under its Voluntary Correction Program identifying certain aspects of the plan as noncompliant with IRC §401(a)).

Summary Regarding Fiduciary Duty of Care

- Duty of care = Duty of prudence
  - Prudence requires *asking questions and understanding the rationale* for actions before taking them
  - Prudence requires *analyzing advice* and *recommendations* received from experts, not acting as a "rubber stamp," but also, if not adopting the experts' recommendation(s), having a reasonable basis for doing so that is *informed by the applicable expertise* implicated by the decision and that is consistent with fiduciary duties
  - Prudence requires *following the Plan Document and other applicable law*, as well as the Board regulations, policies, resolutions and other rules governing the retirement system

Fiduciary Duty of Loyalty: Exclusive Benefit Rule

– "The assets of the . . . retirement system are *trust funds and shall be held for the exclusive purposes of providing benefits to participants in the…retirement system and their beneficiaries* and defraying reasonable expenses of administering the system."
  - Cal. Const., art. XVI, § 17(a) (emphasis added).

Fiduciary Duty of Loyalty: Prompt Delivery of Benefits and Related Services

- "The retirement board of a … retirement system shall have the sole and exclusive fiduciary *responsibility…to administer the system in a manner that will assure prompt delivery of benefits and related services* to the participants and their beneficiaries…"
  - Cal. Const., art. XVI, § 17(a) (emphasis added).

Fiduciary Duty of Loyalty:
Primary Duty Rule

- “The members of the retirement board . . . shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. *A retirement board’s duty to the system’s participants and their beneficiaries shall take precedence over any other duty*.”
  – Cal. Const., art. XVI, § 17(b) (emphasis added).

Fiduciary Duty of Loyalty: Collateral Interests?

- California court recently noted that the duty of loyalty requires retirement system fiduciaries to put the overall best interest of members and beneficiaries <u>ahead of the interest of employers</u>, if those interests conflict:
  - "An abuse of discretion occurs when a trustee acts from an improper even though not dishonest motive, such as when the act is undertaken in good faith but for a purpose other than to further the purposes of the trust or, more specifically, the purposes for which the power was granted." *O'Neal, supra*, 8 Cal.App. 5th at p. 1209 [citing Rest. 3d. Trusts, §87, com. c, p. 244.].

Fiduciary Duty of Loyalty: Collateral Interests?

- Collateral interests of Board members?
  - The strict duty of loyalty in trust law ordinarily prohibits the trustee from…investing in a manner that is intended to serve interests other than those of the beneficiaries or the purposes of the settlor. *Thus, for example, in managing the investments of a trust, the trustee's decisions ordinarily must not be motivated by a purpose of advancing or expressing the trustee's personal views concerning social or political issues or causes.*
    - Rest. 3d Trusts, supra, § 227, p. 12, comment c (emphasis added).

Fiduciary Duty of Loyalty: Conflicting Interests Among Various Members and Beneficiaries

- Can be complex and crosscutting.
- Determinations of priorities among members and beneficiaries must serve the *overall best interest of members and beneficiaries of the retirement system*.
- Appropriate balance may not be obvious when the interests within the member and beneficiary groups are not the same.

Fiduciary Duty of Loyalty: Conflicting Interests Among Various Members and Beneficiaries

- Dissimilar interests among beneficiaries are built into most trusts.
- Trust law has evolved to grant trustees a fair measure of discretion to balance those competing beneficiary interests.
  - *See* Rest. 3d Trusts, §§ 50, 183 comment a, and 232; *Estate of Bissinger*, 212 Cal.App.2d 831, 833 (no liability where trustee bank "acted reasonably, prudently, in good faith and in the exercise of its best judgment…and with the intention of being fair to both the income and remainder beneficiaries"); and IIIA Fratcher, Scott on Trusts, § 232, p. 7 (4th ed. 1988) ("The trustee, however, ordinarily has considerable discretion in preserving the balance between beneficiaries").

Fiduciary Duty of Loyalty

- Conflicting Interests Among Members and Beneficiaries?
  - Examine specific provisions, and identified purposes, if any, in Plan Document and determine means to implement those provisions and serve those purposes.
  - Consider number of active, deferred and retired members and their beneficiaries affected by Board action.
  - Consider degree of hardship created by potential curtailment or provision of particular benefit.
  - Consider equities as between members/beneficiaries.
  - Consider whether proposed action implicates any vested rights of members/beneficiaries, including, without limitation, actuarial competency of retirement system assets to pay promised benefits.

Fiduciary Duty of Loyalty: Not An “Agent” for Another

- Trustees are not permitted to administer the retirement system as an “agent” for the party that appointed, or subgroup of members that elected, that individual to the Board.
- On the contrary, the California Constitution, Art. XVI, Sec. 17 (Prop. 162) seeks to prevent such political “meddling” or “interference” by others and mandates loyalty to the overall best interest of members and beneficiaries.
  - *See generally NLRB v. Amax Coal Co*., 453 U.S. 322 (1981) (no “dual loyalties”); *Hittle v. Santa Barbara CERA*, 39 Cal. 3d 374 (1985) (traditional fiduciary duties apply to public retirement system trustees); *Claypool v. Wilson*, 4 Cal.App.4th 646, 676-7 (1992) (Cal. Const., art. XVI, sec. 17 imports the existing law of trusts).

Fiduciary Duty of Loyalty: U.S. Supreme Court in *NLRB v. AMAX*

- Under traditional employee benefit trust law, even though the pre-ERISA statute: "requires an equal balance between trustees appointed by the union and those appointed by the employer, *<u>nothing in the language</u> of [the provision] reveals any congressional intent that a trustee should or may administer a trust <u>fund in the interest of the party that appointed</u> him, or that an employer may <u>direct or supervise</u> the decisions of a trustee he has appointed.*" 453 U.S. at 331 (emphasis added).

Fiduciary Duty of Loyalty: Employer Contributions?

- California authorities have, however, permitted public retirement system fiduciaries to take actions that result in reduction in employer contributions so long as:
  - Those actions do not compromise competency of assets of the retirement system to pay promised benefits;
  - No conflict of interest arises in doing so; and
  - The action is in the overall best interest of members and beneficiaries as that interest relates to matters of proper concern to the retirement system.
    - *See generally Bandt v. Board of Retirement* (2006) 136 Cal.App.4th 140; see also *Claypool v. Wilson* (1992) 4 Cal.App.4th 646.

Fiduciary Duty of Loyalty: Employer Contributions?

- Recent *O'Neal* decision also endorsed the conclusion in *Bandt* that "a retirement board could consider its active members' interest in retaining their jobs when making funding decisions." *O'Neal, supra*, 8 Cal.App. 5th at p. 1219.
- Further, *O'Neal* stated that "a trier of fact could view conduct preserving current jobs as good for current retirees who rely on continuing contributions to ensure the viability of their retirement." *Id*.
- *However*, the court in *O'Neal* required a trial to be conducted to determine whether there was a breach of the duty of loyalty in that instance. *Id*.

Fiduciary Duty of Loyalty: Employer Contributions?

- Furthermore, *O'Neal* concluded, "an issue of fact arises as to whether the board's balancing of a single year of improved job prospects against a perpetual funding shortfall that could leave the pension system unable to pay benefits violates StanCERA's duty of loyalty."
- Case was remanded for trial, which occurred during the Summer of 2018, superior court ruled in January 2019.

Fiduciary Duty of Loyalty: Employer Contributions? (*O'Neal II*)

- Trial court decision:
  - No breach of duty of loyalty by Board.
  - Evidence focused on the processes followed by the Board, including statements made during public sessions regarding rationale for decision making.
  - Court found that the Board properly exercised due diligence after considering legal and actuarial advice, and acted conservatively to ensure that members would receive vested benefits, in the face of a "five-alarm fire."
  - No clear evidence that the Board took actions solely or primarily to benefit the County or to place the interests of the County ahead of the plan members.
- Plaintiffs appealed trial court decision.
  - Briefing should be completed during 2019.
  - Court of Appeal decision in "*O'Neal II*" likely 2020-2021.

Processes to Demonstrate Fiduciary Compliance

- Recognize that although Courts afford Boards broad discretion in decision-making, “exclusive authority” is not absolute discretion
- Avoid “abuse of discretion”
  - Process important – make sure record reflects that process: minutes reflecting deliberation, written materials provided by expert consultants
  - Education, inquiry, disclosure of reasons for action, reflecting due consideration to overall best interest of members and beneficiaries
  - Active independent actuarial oversight
  - Active independent investment oversight
  - Legal consultation and compliance with applicable law

Fiduciary Goal

- A Board of Retirement must use *informed judgment* and *act in the overall best interest of system members/beneficiaries* in a manner that is *consistent with applicable laws* when exercising its plenary authority over administration and investments, and its actions in that regard *may not be "arbitrary" or "capricious"* and *must be rationally related to the information* presented to the Board.

Thank You!

Ashley K. Dunning
Co-Chair Public Pensions & Investment Group
San Francisco
415.398.3600
adunning@nossaman.com