A PARTNERSHIP OF PROFESSIONAL ASSOCIATIONS
ATTORNEYS AT LAW

ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

BOARD OF TRUSTEES FIDUCIARY EDUCATION PROGRAM

LITTLE ROCK, ARKANSAS

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I. THE PURPOSE OF THE MATERIALS

The purpose of the following materials is to provide a sampling of legal, financial, ethical, and philosophical material related to the mission of a fiduciary. The idea of a fiduciary being the steward of another's property is centuries old. No one outline could cover the entirety of the volumes of court decisions, scholarly articles, and economic treatises on the subject. It is hoped that the materials here will provoke thought and discussion on an on-going basis for the betterment of APERS.

II. FIDUCIARY DUTY - A DEFINITION

A. <u>Fiduciary Defined</u>

1. A person is a fiduciary with respect to an employee benefit plan to the extent he/she exercises discretionary authority with respect to plan and assets.

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2. Exercise of discretion is the key.

3. Can include more than just the trustees.

4. Extends to investment management and consultants.

B. Judicial Standards

1. **Meinhard v. Salmon**, 164 NE 545 (Ct.App. 1928).

   Court determines that common standard of the marketplace is unacceptable to fiduciaries. General trust standard was expanded for pension trustees to include a definition of "undivided loyalty" to be applied with "uncompromising rigidity."

2. **NLRB v. Amax Coal Co.**, 453 U.S. 322 (1981).

   U.S. Supreme Court holds that plan trustees have an "unwavering duty of complete loyalty" to members and beneficiaries. Trustees cannot serve any master other than the fund. The pressures of undivided loyalty are inconsistent with the give and take of collective bargaining.

III. ARKANSAS'DEFINITION OF A FIDUCIARY

A. The Code has Several Sources of Fiduciary Duty

1. A.C A 24-2-610 defines the Board as a fiduciary with regard to investment matters adopting the prudent investor standard.

2. A.C.A. 24-2-611 outlines the standard to be applied and the test for determining the reasonableness of an investment decision.

3. A.C.A. 24-2-614 places the Board firmly within the standard of loyalty for a trustee.

4. A.C.A. 24-2-618 allows the Board to delegate functions but not the ultimate fiduciary responsibility.

5. A.C.A. 24-2-701 extends the Board's fiduciary duty to adoption of reasonable actuarial standards and assumptions, including the required contributions.

6. A.C.A. 24-4-101 gives the Board broad authority to manage the System and determine questions concerning its application and interpretation. This authority has been deemed highly persuasive and entitled to judicial deference unless clearly wrong. *APERS v. Taylor*, 2013 Ark. 37, 425 S.W.3d 738; Ark. Op. Atty. Gen. 99-280, 1999 WL 1532206.

7. The Board would generally have sovereign immunity as an arm of the state pursuant to Article 5, Section 20 of the Arkansas Constitution. The Board would also have immunity under the 11th Amendment of the U.S. Constitution from most federal claims. An exception to this rule is when an agency acts in an *ultra vires* manner (contrary to its statutory authority) or in an arbitrary or bad faith manner. *Johnson v. Butler,* 2016 Ark. 253, 494 S.W. 3d 412.

B. Constitutional Authority Relating to Pensions

Article 16, Section 4 of the Arkansas Constitution authorizes the Legislature to set the compensation of officers and employees (except the judiciary) by law. Pension bills may not be established buy local or special law. Article 2, Section 17 of the Arkansas Constitution prohibits impairment of contract. This protects vested benefits as defined by law. *Robinson v. Taylor*, 342 Ark. 459, 29 S.W. 3d 691 (2000)

C. Judicial Definition

Fiduciary duty to the members means to deal fairly and act in good faith in the fulfillment of the statutory duties. Observance of statutes, even if results may be uneven as to particular individuals is not a breach of fiduciary duty. *Bakalekos v. Furlow*, 2011 Ark. 505, 410 S.W. 3d 564

D. APERS Board Regulations

Board members must act solely in the best interests of the participants and beneficiaries of the system and for the exclusive

purposes of providing them with benefits and defraying reasonable administrative expenses.

This duty of loyalty means Board members must only wear one hat as a trustee and not at the same time wear a second hat as a representative of outside interests.

Communication with investment professionals on behalf of the Board is to be handled by the Administrative Staff. Regulations pp. 33-37

E. Where Does the Legal Duty to Act Lie?

1. Trustees have a duty to secure full payment of all contributions owed to the Fund in a timely manner.

2. Trustees have a duty to enforce the provisions of the legislation as written. If legislation proves to be unwise, it is a matter for the Legislature to resolve.

3. Trustees have a duty to adopt sound actuarial and investment policies designed to protect the interests of the members and beneficiaries of the System.

4. Trustees have a duty to act in a collegial manner and as a collegial body.

5. In recognition of the ever-changing duties and challenges facing trustees, continuing trustee education is essential.

F. Modern Portfolio Theory - The Difference Between the Prudent Person, the Prudent Investor, and the Prudent Expert

1. In the literature discussing the duties of pension trustees in the area of investment responsibility, terms like "prudent person," prudent investor," and "prudent expert" are used. While the terms are sometimes used interchangeably, their histories and meanings are distinct.

2. In *The New Prudent Investor Rule and Modern Portfolio Theory: A New Direction for Fiduciaries,* Alberts and Poon, 34 AMBJ 39 (1996), the history of fiduciary duty is explored at length from its biblical origins in Luke 16:1-8, 10 (the parable of the stewards) and St. Thomas Aquinas' *Treatise on*

Prudence and Justice through the creation of the prudent expert rule under ERISA. American jurisprudence is said to begin with the decision in *Harvard College v. Amory*, 26 Mass. (9 Pick) 446 (1830) in which the Court held:

> *All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.*

3. The adoption of the Employee Retirement Income Security Act of 1974, further extended this rule to a new, higher standard. The operative provisions of Section 404(a), codified as 29 U.S.C. 1104 (a)(1)(B), require a fiduciary to discharge his or her duties:

> "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

4. While ERISA Section 404 (a) has its foundations in the prudent person and prudent investor rules, legal scholars have concluded that the statute created a new "prudent expert rule."

5. While the ERISA standard is obviously based on the common law prudent investor rule, in many respects ERISA goes well beyond traditional requirements. For example, ERISA requires the care that a "man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." This has been termed the "prudent expert" rule (as opposed to the prudent investor rule's "managing his own property" standard) and is perceived as imposing a higher standard. The legislative history indicates that the "enterprise of like character" language was intended to form a standard that would consider the attributes and diversity of employee benefit plans in federalizing the

common law of trusts. Another major change wrought by ERISA is that it permits a fiduciary to emphasize the performance of the overall portfolio as compared with the performance of each individual investment. At common law, the fiduciary was required to defend the performance of each individual investment in the portfolio. Bobo, *Nontraditional Investments of Fiduciaries: Re-Examining the Prudent Investor Rule,* 33 Emory L J 1067, 1078 (1984). See also, Hughes, *Hot Topics and Important Considerations for Retirement Plan Fiduciaries,* 57 - Jul Advoc 38 (June/July 2014), Note 7.

6. The key, according to the prudent expert standard is whether the trustees, at the time they engaged in an investment, employed appropriate methods to investigate the merits of the investment and its structure. *Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc.,* 173 F.3d 313 (5th Cir. 1999); *Donovan v. Mazzola,* 716 F.2d 1226 (9th Cir. 1983). Perhaps more importantly, the prudent expert standard (found in the Restatement (Third) of Trusts) greatly expands a trustee's ability to delegate to investment professionals. See, Langbein, *Reversing the Non-Delegation Rule of Trust - Investment Law,* 59 MOLR 105 (1994).

7. ERISA specifically exempts governmental plans like OPERS. The reasoning at the time, and continuing today, is the management and funding of state and local government retirement plans is not a federal issue. It has been deemed a reserved power of the states under the 10th Amendment of the U.S. Constitution.

IV. RESPONSIBLE INVESTING

A. <u>Environmental, Social and Governance (ESG)</u> - Incorporates these issues into the investment decision making process. These approaches may involve active proxy voting, company engagement, and public policy work.

B. Divestiture Law Held Unconstitutional

Darfur Investment Restrictions Struck Down by Federal Court.

In an effort to deny support for the government of Sudan and its affiliated Jinjaweid militia in light of the atrocities and genocide in Darfur, the state adopted the Illinois Act to End Atrocities and Terrorism in the Sudan. The act attempted to impose various restrictions on the investment of public pension funds in Sudan-connected entities and on the deposit of state funds in financial institutions whose customers have certain links with Sudan. Among other things, the Act amended the Illinois Pension Code to prohibit the fiduciary of any pension fund established under the Code from investing in any entity unless the company managing the fund's assets certified that the fund managing company has not loaned to, invested in, or otherwise transferred any of the retirement system or pension fund's assets to a forbidden entity any time after the effective date of the Act. Several Illinois municipal pension funds and beneficiaries challenged the constitutionality of the statute in a suit brought under 42 USC 1983 against the state treasurer and attorney general. The plaintiffs argued that the Act is preempted by federal law governing relations with Sudan, interferes with the federal government's ability to conduct foreign affairs, violates the Constitution's Foreign Commerce Clause, and is preempted by the National Bank Act. The court recognized that the Illinois Legislature acted with laudable motives. The Federal District Court for the Northern District of Illinois held that the Illinois act violated various federal constitutional provisions precluding the states from "taking actions that interfere with the federal government's authority over foreign affairs and commerce with foreign countries." The District Court enjoined the state from enforcing the act.

National Foreign Trade Council v. Alexi Giannoulias, 2007 WL 627630 (N.D. Ill. Feb. 23, 2007).

Congress later acted to enable state action in the Sudan Accountability and Divestment Act of 2007.

C. Constructive Engagement

Many states, as an alternative to divestiture, have adopted laws requiring constructive engagement. This involves requiring managers to inquire of companies holding stock in areas of concern

to directly engage those companies to seek change within the challenged area. Florida has a direct prohibition relating to Cuba in 215.472, which will be directly impacted by recent federal outreach to normalizing relations with Cuba. For example, as an alternative to divestment, which would have substituted the legislature as the fiduciary for the boards of trustees, Louisiana law encourages public retirement systems to engage companies to foster change from within rather than simply withdraw from the marketplace. This shifted the decision-making back to the boards of trustees who are tasked with ensuring positive investment performance, based on non-political factors.

D. **Divestiture of Fossil Fuels**

1. Generally shunned by pension plans and large endowments as destructive of the mission of achieving the highest and best return at a reasonable risk.

2. Divestiture has most recently been criticized for loss of an investor voice in a critical industry that directly impacts virtually every economic sector in which pension plans are invested.

3. The first question to ask in any mission-based divestment decision is whether the divestment will advance or damage the long-term return of the System or will otherwise enhance or resist risk management in the portfolio. If the increased risk or diminished return is the most likely result, the social issue, no matter how worthy must take a "back seat" to the primary mission of the fiduciary to invest System assets for the highest and best return with a reasonable degree of risk.

E. **Department of Labor Issues Advisory Opinion on Proxies**

1. The U.S. Department of Labor, which regulates ERISA plans, issued a recent advisory opinion which may have influence on governmental plan efforts to address political issues in proxy matters. Fiduciaries are required to act in the best interest of the members of the retirement plan. This includes the duty to exercise proxy votes on issues that affect the value of plan investments. The DOL stated it is the duty of fiduciaries to weigh the cost of developing proxy resolutions, proxy voting services and the likely effect of such activities on the value of the plan investment.

2. The DOL went on to state that any activities designed to monitor or influence the management of a corporation is consistent with the fiduciary duty under ERISA only to the extent it is expected to enhance the value of the plan investment in an amount over and above the cost of the activity. The opinion clearly advises fiduciaries against proxy activities that relate to political or social issues unless it can be shown that the activity will also enhance the value of the stock. DOL Advisory Opinion 2007-07A

F. **What is the ERISA Standard?**

2509.94-1 Interpretive Bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor's interpretation of Sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in "economically targeted investments" (ETIs), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. Sections 403 and 404, in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a-1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of

action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate Section 404(a)(1) (A) and (B) and the exclusive purpose requirements of section 403.

On October 26, 2015, the DOL addressed the concern that interim guidance given in 2008 had unduly discouraged ERISA fiduciaries from considering the social impact of an investment decision. The DOL recognized in its 2015 guidance that ESG issues "...may have a direct relationship to the economic value of the plan's investment."

The DOL guidance is in no way binding on a state or local government plan due to the ERISA exemption for governmental plans, but it is instructive in the shifting view that the ESG component of an investment may well have a measurable economic impact on the System. This is especially so for a fund like APERS with language closely mirroring that of ERISA.

V. WHAT DOES DE MINIMIS MEAN IN THE FIDUCIARY CONTEXT?

A. How the Process Has Been Applied in Investment Decisions

1. In deciding to follow or to decline a divestiture mandate, the System has looked to whether the effect on the portfolio is "de minimis."

2. How is de minimis defined?

3. Black's Law Dictionary defines de minimis as "of the least" or "trifling; minimal" and a fact or thing that is "so insignificant that a court may overlook it in deciding an issue or case."

4. In the context of an investment decision when is an effect de minimis?

5. *De minimis non curat lex* - The law does not concern itself with trifles.

6. At least one state, New York, rejected the above maxim in the context of a fiduciary duty. In *Sorin v. Shahmoon Industries*, 220 N.Y.S.2d 760 (N.Y. App. 1961), a waste of corporate assets challenge, the court held that where a fiduciary's duty to account is at issue, it is a question of "principle," not principal. When a fiduciary is to account for funds entrusted to his or her care, it means all funds "not some, or even most."

7. The leading (and really the only) case in this context remains *Board of Trustees v. Mayor and City Council*, 562 A.2d 720 (Md. 1989). The trustees of the City pension fund sued to challenge ordinances requiring divestiture of holding in companies doing business with the Apartheid government of South Africa. In upholding the ordinances, the Court observed that given "vast power that pension funds exert in American society, it would be unwise to bar trustees from considering the social consequences of investment decisions," where the cost was de minimis. In the Baltimore case, the trial court found that the initial cost of divestment was 1/32 percent (3 basis points) and the on-going cost was 1/20 percent (2 basis points. To date this remains the only public pension case giving some concrete definition to the term "de minimis" in the divestment context.

8. A similar holding was reached by an Oregon trial court concerning investment by the State Investment Council but the decision was overturned on appeal when the student plaintiffs were found to lack standing sufficient to challenge the investment decision. *Associated Students v. Oregon Investment Council,* 728 P.2d 30 (Or. App. 1986).

B. What if Survival Is at Stake - Are the Rules Different?

1. In *Withers v. Teachers' Retirement System*, 447 F.Supp. 1248 (S.D.N.Y. 1978), the Board of Trustees agreed to buy $2.53 billion (approximately $10 billion in 2015) in New York City bonds to prevent the City from becoming insolvent. This commitment raised the amount of the portfolio in City securities to more than 37%. Members of the plan sued the trustees for breach of fiduciary duty. Ultimately, the Court ruled that trustees acted reasonably as the insolvency of the City would have led to depletion of the retirement system within less than 10 years. The court rejected the claim of breach of fiduciary because the motivation of the decision was the long-term solvency of the System and not the long-term welfare of New York City. The trustees reasonably feared that in bankruptcy, the protection of employee benefits would be secondary to claims of bondholders and the preservation of essential public services.

C. What is De Minimis in the Context of Board Governance?

1. The Board has a duty to the membership as a whole and not any particular segment of the membership to the detriment of any other.

2. Decision making must reflect that standard.

3. Vigorous and healthy debate internally is critical. Trustees should feel unconstrained to speak their minds.

4. How does this idea of vigorous debate change after a decision has been reached by the Board?

5. What process should a prudent board of trustees employ in making decisions that have uneven effects on membership?

6. Board decisions may end up subject to judicial review but that does not mean the Board acted without authority. *Duncan v. Tennessee Valley Authority Retirement Systems,* 833 F. 3d 567 (6th Cir. 2016).

VI. WHAT DO SUITS AGAINST INVESTMENT FIDUCIARIES LOOK LIKE?

A. Fallout from Unfavorable Investment Performance

The common result of an unfavorable investment result over the last 10 years has been a proliferation of suits by plan participants against the trustees. The following are some notable examples:

1. Suit against state retirement plan barred by immunity

A group of Michigan state court judges filed suit against the judicial retirement system and its trustees claiming denial of equal protection in that Detroit area judges received more favorable treatment than other state judges. In addition, the judges sued for common law trust violations and breach of fiduciary duty. A federal trial court dismissed the case on the basis that the retirement plan was "an arm of the State" and therefore immune from suit under the 10th and 11th Amendments of the U.S. Constitution. A federal appeals court sitting en banc (all 14 active judges) held that the federal suit was properly dismissed but the trial court should have allowed the plaintiffs to re-file their claims in the appropriate state court. The appeals court found that the question of whether a pension plan was an arm of the state was dependent on the degree of control by the state, the involvement of the state treasury, and the degree to which the plan constituted a traditional state function. The appeals court was careful to distinguish suits by individuals against a state from suits by the federal government against a state or suits by one state against another. The appeals court also noted that counties and cities do not enjoy the same immunity as a state.

Ernst v. Rising, 427 F.3d 351 (6th Cir. 2005)

2. Case against teachers' retirement system dismissed based on lack of injury

Texas courts issued the first decision on fiduciary duty and pursuit of investment policy. Although it is an unreported decision, meaning it has no precedential value, it nonetheless warrants some review. A member of the Teachers Retirement

System brought a class action lawsuit against the system for violation of the takings clause of the Texas Constitution and breach of fiduciary duty. The member claimed that the Teachers Retirement System and the trustees violated their constitutional duty to refrain from engaging in speculative investments. The Teachers Retirement System had published a financial highlight report for the 2008 fiscal year which demonstrated a loss representing a negative 4.5% total fund return for the year ending August 31, 2008, including a loss of $415,383,006.00 due to derivative investments. The member claimed that the derivative investments were considered speculative and should not have been made by the system and the trustees. The court ultimately dismissed the lawsuit based upon the doctrines of standing and ripeness. The court determined that since the system was a defined benefit plan, the member did not have standing because there was no real controversy between the parties as the defined benefit plan guaranteed benefits to all members. The court also held that the case was not ripe because an injury had not occurred to the members. The court did state that if the system denied any retirement benefits to any teachers, or the Texas Legislature increased mandatory contributions as a result of the investment loss, then at that time they may be able to state a claim. How this will relate to a cash-balance or hybrid plan is unknown. It would appear that to the extent a particular form of investment has no measurable impact on member account values, the same result would apply.

Ramon v. Teachers Retirement System of Texas, 2010 WL 1241293 (Tex. App. - Hous. April 1, 2010) (unreported).

3. New Mexico retirees cannot sue for investment losses to system.

New Mexico teachers were held to lack standing to recover 2008 investment losses. During the national economic crisis in 2007-2008, the New Mexico Educational Fund ("Fund") lost approximately $40 million on certain private equity investments. The Fund holds approximately $8.5 billion in assets used to pay benefits for 95,000 teachers and other participants. Teachers brought suit against the Fund, Board members and investment advisers for breach of fiduciary duty,

violation of federal and state securities laws, aiding and abetting breach of fiduciary duty, and breach of contract. Plaintiffs alleged that they were injured by defendants' improper investments due to potential increased employee contributions, reduced services, tax increases, and the increased risk that the Fund would not have sufficient assets to satisfy its obligations in the future. The court held that plaintiffs could not show that their benefits were threatened, that the system was currently underfunded, or that the challenged investment caused the underfunding.

The court recognized that altering retirement eligibility or contribution requirements would require the legislature to act. Under these circumstances, plaintiffs lacked standing to sue. Plaintiffs' allegations that they faced the risk of tax increases, potential future benefit reductions or increased contribution levels, and that they were injured by the loss of principal, income, fees, and expenses did not establish an injury in fact fairly traceable to the defendants.

State governmental entities, including public employees/trustees acting within the scope of their duties, are immune from liability for any tort, except as waived by law. The court held that breach of fiduciary duty is not one of the tort claims for which the New Mexico Legislature chose to waive governmental immunity under New Mexico's Tort Claims Act. After granting the motion to dismiss in part, the federal district court remanded the case to New Mexico state court given a lack of subject matter jurisdiction.

Hill v. Vanderbilt Capital Advisors, 834 F.Supp2d 1228 (D.N.M 2011)

4. Michigan class action for breach of fiduciary duty relating to investments results in an adverse finding.

In September of 2009, the trial court certified a class action consisting of participants and beneficiaries of the Detroit Plan who were seeking to recover millions of dollars resulting from investments which "in hindsight should not have been made" (quoting from the Defendants' brief). Eight cases were consolidated for appeal.

The Appeals Court issued a lengthy opinion dismissing some claims on the basis of discretionary immunity. The Michigan Court of Appeals also held that the participants had standing to pursue their state law claims under the public pension investment fiduciary law against the investment advisor defendants. The members were also held to have standing to assert their (I) common-law and statutory conversion claims; (ii) causes of action grounded in the trustee defendants' "extravagant, unnecessary and improper trips", and (iii) I claims against trustee defendants and investment advisor defendants for violation of Art 9, Section 24 of the Michigan Constitution which protects "accrued financial benefits."

Estes v. Adrian Anderson (unpublished) 2012 WL 5857283 Mich. App. 2012).

5. **Statute widening discretionary authority of board in actuarial matters does not impair member rights.**

A retired state employee sued the Public Employees' Retirement System arguing that a statute which changed the method by which the board calculated certain retirement benefits and which resulted in a lower monthly benefit to the employee was an unconstitutional delegation of legislative power to an administrative agency. The Montana Constitution expressly protects public employee retirement benefits. It also authorizes the board of trustees to set actuarial standards for the system. Following the adoption of that constitutional provision, the Legislature passed a law at the request of the retirement system empowering it to set "actuarial equivalents" for certain survivorship benefits. The board adopted a more modern mortality table which resulted in an increase in the actuarial reduction applied to certain survivorship benefits. This meant that an employee selecting a survivorship benefit would receive a lower lifetime annuity. The employee sued claiming that the board unconstitutionally impaired his retirement benefits and exercised a legislative power by adopting a different mortality table. The Montana Supreme Court rejected the argument finding that the people of Montana expressly authorized the board of trustees as a

fiduciary to set actuarial standards for the system and its action was therefore not an unlawful delegation of power.

Baumgardner v. PERB, 119 P.3d 77 (Mont. 2005).

B. The Boards are not Alone

Numerous actions have resulted in major decisions involving suits by both systems against professional advisors and most recently by participants against professional advisors.

1. Retirement system was not contributorily negligent and thus actuary was liable for $72,000,000 in lost contributions and lost interest.

Milliman was hired in 1982 to provide actuarial valuations for each of Maryland's state systems. In 2004, Milliman discovered a longstanding coding error during a replication audit. Milliman's calculations treated code "00" as meaning only a straight life annuity, even though code "00" also included 50% survivor spouse benefits. The State Board of Contract Appeals determined that Milliman had breached its contract to provide actuarial services. The System was awarded $34 million in lost contributions and $38 million in lost interest on those contributions. Milliman appealed arguing that the System was not damaged insofar as the taxpayers would fund any deficiency. Milliman also argued that the System was not harmed because notwithstanding the 22 years of actuarial errors, ultimately the System would become fully funded. The lower court determined that this perspective "subverts the entire function and purpose of actuarial analysis, which is to determine how much to contribute and when." If Milliman's arguments were accepted, it could satisfy its contractual obligations by training a monkey to punch random keys on a calculator. The Maryland Court of Appeals, the highest court in the state, agreed. It rejected Milliman's argument that the state retained the use of the contributions, which were not deposited into the System. The Court refused to recognize an offset, finding that the state and System are distinct entities.

According to the Court, to the extent that the data coding may have been confusing, the actuary bore an express duty to

solicit further clarifying information until it accurately understood the information provided by the system. The court credited the testimony of a third-party actuarial expert, witnesses, and trustees that the System had suffered losses and was underfunded as a result of the errors.

On the voluminous records, the court held that substantial evidence supported the lower court's findings that Milliman repeatedly misinterpreted a data code associated with survivors' benefits. The System was not negligent in the development or transmission of the data. As a result, Milliman was fully liable and contributory negligence was not a bar to recovery.

Milliman, Inc. v. Maryland State Retirement and Pension System, 25 A.3d 988 (Md. 2011).

2. Member suit against actuaries reinstated.

In November, 2014, a California appeal court reinstated a member suit against a retirement system actuarial firm and the individual actuary, even though the claims against the System were dismissed. Beneficiaries of the Stanislaus County retirement system sued the System for accepting erroneous actuarial assumptions which lead to the underfunding of the plan. The members also sued the actuarial firm. The claim against the Board related to its determination not to sue the actuaries. The Court of Appeals upheld a dismissal of the claim against the System on the basis of discretionary governmental immunity. It reinstated the claim against the actuaries for allegedly aiding and abetting a breach of fiduciary duty by encouraging the trustees to make improper actuarial and funding determinations.

Nasrawi v. Buck Consultants, *LLC,* 231 Cal. App.4th 328 (6th Dist. 2014), review denied 2015.

VII. WHAT HAVE WE LEARNED?

A. In large measure fiduciary duty is common sense about right and wrong. If an issue gives one pause for thought that it might be wrong, it probably is.

B. The primary duty of a pension fiduciary is to act in the best interests of ALL members and beneficiaries of the System. Only if that result abides, do additional concerns enter the decision process.

C. Liability is largely the product of poor planning and a failure to recognize its consequences.

D. Pension trustees have 2 jobs - (1) set policy and (2) demand accountability that the policy is being properly executed.

E. Understand the subject matter. Ask appropriate questions to get an answer.

F. Delegation to staff and professionals IS the exercise of fiduciary duty if there is continuing accountability.

G. Micro management and policy making are poor partners and are NOT the appropriate exercise of fiduciary duty.

H. Follow the statutes and regulations. If they are deemed unworkable, seek an amendment.