PERSist

National Conference on Public Employee Retirement Systems

The Voice for Public Pensions

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NCPERS 2010 Annual Conference & Exhibition: Pension Professionals Convene for Learning & Networking

Pat McElligott delivered his second keynote address to open the 2010 Annual Conference and Exhibition, held May 2–6 in Las Vegas, NV. He talked about the need to educate the public, government officials, and the media about how well funded most public employee pensions are.

"This year," he reminded the audience, "of the 71 public pension plans that have submitted their 2009 contributions, only 32 reported paying their full pension bill. Government budget crises are not our fault."

Attendance at the conference, at the Wynn Las Vegas Hotel, exceeded last year's turnout, with just under 1,000 registrants and 61 exhibitors. Presentations from the conference are available on this website by clicking here.

Robert M. Maynard, CIO with the Public Employee Retirement System of Idaho, also delivered a keynote address. Maynard discussed long-term versus short-term market investment strategies. He compared the conventional strategy with the endowment model, including a stress-test comparison of the two models during the "Great Collapse" of 2008–2009. He also discussed concerns around hedge fund investing and issues around public versus emerging private market investment.

Morton Kondracke, executive director of *Roll Call*, the Capitol Hill newspaper, also addressed the group. He gave an up-to-the minute look at American politics, including the November elections. Dan Crippen, former director of the Congressional Budget Office, delivered an overview of the current health-care debate and policies and spoke on options for repairing America's ailing health-care system.

During the conference the members also elected the following officers to one-year terms:

- Pat McElligott, of Tacoma, WA, vice president

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Fiduciary liability – know your relief, know your risk

By Paul Hebert, JD Area Vice President Gallagher Retirement Services and Mike DiCenso, AIF, PRP, National Practice Leader Gallagher Retirement Services, President GBS Investment Consulting, LLC

The financial risks inherent in being a fiduciary are significant. So a main concern of many retirement plan fiduciaries is finding ways to minimize risk. Unfortunately, the promise of reducing or eliminating fiduciary liability has become a marketing ploy in the industry, with offers of release from fiduciary obligations or even fiduciary warranties.

Just to be clear

We've been down this road many times, but we need to be clear. The plan sponsor (which is usually the employer) and any trustees are automatically considered fiduciaries. Additionally, many companies create employee committees made up of non-trustee employees, who conduct an oversight function with the ability to select a new provider or investment options. These committee members are considered fiduciaries as well – and there is no way around it. ERISA defines a fiduciary as anyone who

- exercises discretionary authority or control over the management/disposition of plan assets,
- renders investment advice for a fee,
- has discretionary authority in the administration of the plan, or
- is named as a fiduciary in the plan document.

The individuals identified above are fiduciaries and always will be fiduciaries.

What are the duties of a fiduciary?

First, the fiduciary must act solely in the best interest of plan participants and their beneficiaries. **Second**, the fiduciary must act for the exclusive purpose of providing benefits to the participants. **Third**, the fiduciary must use the care, skill, prudence, and diligence under circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use. This is called the prudent expert standard. In other words, the Department of Labor judges a person's ability to perform fiduciary duties as though he or she performed these duties for a living.

The risks of being a fiduciary

Fiduciaries are personally liable for any breaches in fiduciary duty. In recent years, several cases have had sanctions or judgments in the seven-figure range. A plan fiduciary who breaches his or her duty

- will be held personally liable,
- must make up any plan losses and lost opportunity costs,
- must pay participants' attorneys' fees, and
- is often subject to stiff civil and criminal fines.

Ways to limit fiduciary liability

Even though a fiduciary will always bear some risk, he or she can do certain things to limit liability, such as allowing participants to direct their accounts under a 401(k) plan, hiring experts to guide him or her through important decisions, and implementing and documenting prudent processes.

A self-directed 401(k) does not fully protect the fiduciary

If plan sponsors give participants the opportunity to exercise control over their individual plan accounts, they can minimize their fiduciary duties regarding losses in those participants' accounts. To effectively give participants control over their accounts, the plan sponsor must satisfy numerous requirements under Section 404(c) of ERISA. Even though 404(c) protects the fiduciary from liability for losses in each participant's individual account, the fiduciary still retains the responsibility for selecting appropriate investments in which the participants can invest and monitoring those investments.

Unfortunately, a lot of false information is floating about, such as the mistaken notion that as long as employees have three or more investment choices, plan sponsors do not need to worry about fiduciary liability. This is simply not true.

Know your fiduciaries, know your risk

ERISA contains various code sections that can give rise to fiduciary status. For instance, an investment manager under ERISA section 3(38) and a named fiduciary under ERISA section 402(a) have been delegated authority by the plan sponsor to make decisions for which they have legal responsibility and liability. These fiduciaries have discretionary authority as defined by ERISA. If an entity has discretion to make a decision, that entity is responsible for that

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Baltimore City Slashes Employee and Retiree Pension Benefits - Is This the "New Normal?"

By Robert D. Klausner, NCPERS General Counsel

The City of Baltimore, effective July 1, took unilateral action to reduce employee and retiree pension benefits. Claiming that the funding requirements of the City's retirement plans were too great a burden on the budget, the City took the extraordinary step of splitting the workforce benefits into two tiers for active employees and also eliminated a variable COLA benefit, replacing it with a fixed-rate COLA at a level that is lower than the average of the variable benefit, which has been in place for over 28 years.

City Council Bill 10-519, which addresses the police and fire retirement system, contains 12 detailed factual findings. Among other things, the findings refer to recommendations from an independent actuary and an independent financial consultant, who apparently describe the plan as unsustainable given the City's structural budgetary deficit. The last finding indicates that the amendments are necessary to implement recommendations "in a manner that minimizes diminution of benefits." This assertion is debatable. Evidence that the amendments are "necessary" is belied by the fact that the City was entertaining benefit enhancements for elected officials. Furthermore, an amendment on third reading to the final enrolled version of 10-519 increases the new minimum benefit for spouses from the original proposed floor of $12,000 to $16,000. The reductions are as follows:

Coverage and effective date: Generally, City Council Bill 10-519's amendments do not apply to members who are eligible for normal service retirement or "have acquired 15 or more years of service credit as a contributing member of the system" on or before June 30, 2010. Accordingly, as far as I can tell, the only part of 10-519 that applies to existing retirees is the COLA amendment. The ordinance takes effect on June 30, 2010.

Delayed normal retirement benefit: It replaces 50 and 10 (or 20 and out) with 55 and 10 or (25 and out).

Actuarially reduced early retirement benefit: The bill replaces the current unreduced benefit at age 50, regardless of years of service, with the following:

- An actuarially reduced early retirement benefit upon attaining the earlier of age 50, regardless of years of service, or 20 and out (for members hired before July 1, 2003)
- An actuarially reduced early retirement benefit upon attaining the earlier of 50 and 10, or 20 years of service with at least 10 in the F&P plan (for members hired after July 1, 2003)

Delayed DROP 2 eligibility: The bill changes DROP 2 eligibility from 20 years to 25 years.

Longer averaging: The bill changes average final compensation from an average of the 18 consecutive highest months to an average of the 36 consecutive highest months.1

Increased member contribution: The bill raises the 6% employee contribution to 7% on July 1, 2010, and annually thereafter by 1% per year, to cap at 10%, beginning July 1, 2013.

Reduced interest rate on member contributions: The bill lowers the interest rate on member contributions from 5.5% to 3%. This affects members who separate prior to vesting, certain duty and non-duty death benefits, and DROP 2 benefits.

Replacement of variable benefit with delayed, fixed COLA: The current variable benefit provides as follows: it applies to eligible retirees and beneficiaries when investment performance exceeds 7.5% as of June 30, it applies in the same percentage for all eligible retirees and beneficiaries, it is paid beginning the next January, and retirees must be in receipt of benefits for two or more years as of June 30 to be eligible.

The proposed COLA does the following: provides a 1% annual COLA for members and beneficiaries who are age 55; provides a 2% annual COLA for members and beneficiaries who have reached age 65; requires retirees and beneficiaries *to now meet the age requirements on their own*; provides members and beneficiaries younger than 55 with no increase; pays *no increase for January 2011*; continues a requirement that must be in receipt of benefit for two or more years as of June 30 to be eligible; and transfers the current variable benefit assets and liabilities to the general account.

The City action is of particular concern in light of the fact that Baltimore has specific contract protection language in its City Charter:

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- Mel Aaronson, of New York, NY, first vice president
- Daniel Fortuna, of Chicago, IL, second vice president
- Richard Wachsman, of Dallas, TX, treasurer
- Tina Fazendine, of Tulsa, OK, secretary
- Elmer Khal, of Cleveland, OH, immediate past president

John Neimiec of Fairfax, VA, was elected to his first term on the board. For the names of all board of directors that members elected to continue on the board, click here.

NCPERS continues the tradition of charitable work, and for the third year the NCPERS Charitable Foundation raised funds for a worthy organization in the conference's host city. The campaign in Las Vegas resulted in contributions of nearly $40,000 that will benefit The Public Education Foundation, a nonprofit dedicated to improving public education in Las Vegas.

Foundation contributions come from two sources: for each fund member attending the annual conference, NCPERS donated $10, and NCPERS members also made direct contributions. Direct contributors were Advantus Capital Management; Dow Jones Indexes; INVESCO; J.P. Morgan Asset Management; J.P. Morgan Worldwide Security Services; Klausner & Kaufman; Loomis, Sayles & Co.; Mesirow Financial; NCPERS staff; Northern Trust; PNC Capital Advisors; Standard & Poor's; State Street; State Street Global Advisors; ULLICO; Virtus Investment Partners; Richard & Marilyn Wachsman; William Blair & Co.; and Wolf Popper LLP.

As a sign of NCPERS' continuing commitment to training, the organization again hosted the highly regarded Trustee Educational Seminar (TEDS). TEDS, which benefits new and novice trustees who are seeking to learn information and skills that will allow them to better serve as fiduciaries for their pension funds, covered topics such as the public pension promise and its implications, elements for all trustees, best practices, actuarial issues, WEP and GPO offsets, and legal issues for new trustees.

On the second day of the two-day training event, the participants took part in the annual Managers Challenge, an interactive team investment exercise. The winners, pictured above Howard Sage, North Dakota Public Employees Retirement System; Joseph Feulner, Cicero Police Pension Fund; and Doug Murch, Jackson County Retirement. More photos from the Annual Conference and Exhibition can be viewed in the Online Photo Gallery. ❖

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Section 42 of Article 22 states as follows:

Upon becoming either a Class A, a Class B or a Class C member of the Employees' Retirement System, or upon becoming a member of the Fire and Police Employees' Retirement System, established under this Article 22, such member shall thereupon be deemed to have entered into a contract with the Mayor and City Council of Baltimore, the terms of which shall be the provisions of this Article 22, as they exist at the effective date of this ordinance, or at the time of becoming a member, whichever is later, and the benefits provided thereunder shall not thereafter be in any way diminished or impaired.

In addition, Maryland has a long history of case law supporting member and retiree rights.

The employees have filed suit challenging the changes, and a long legal battle is expected. The Maryland suit joins a slew of litigation in Florida, California, Massachusetts, Alabama, Minnesota, Colorado, and South Dakota, all seeking protection of retirement benefits. Where such actions for current employees and retirees would have been unheard of a few years ago, governments seem willing to risk judicial reversal, apparently believing that there is little to lose legally and a lot to gain politically with a public that is increasingly less supportive of the pension benefits paid to public workers.

In other words, fighting to protect what were believed to be settled legal rights seems to be the new normal. ❖

This article is a regular feature of PERSist. ***Robert D. Klausner,*** *a well-known lawyer specializing in public pension law throughout the United States, is General Counsel of NCPERS as well as a lecturer and law professor. While all efforts have been made to insure the accuracy of this section, the materials presented here are for the education of NCPERS members and are not intended as specific legal advice. For more information go to* ***www.robertdklausner.com***

Is your organization's membership profile up-to-date?

NCPERS has mailed Membership Update Forms to all main contacts on each member organization's profile. Please complete and return these forms to us as soon as possible.

Keep your organization's profile current to avoid missing out on valuable resources distributed by NCPERS.

The Voice for Public Pensions

Deadline to submit is September 15, 2010

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decision, not the entity that appointed it. This gives a plan sponsor significant relief from fiduciary risk.

But be careful: an individual claiming to be a fiduciary under ERISA section 3(21), because he makes recommendations on which the plan sponsor can act, does not necessarily rise to the level of a plan fiduciary. Even if he is a plan fiduciary based on his actions, that fiduciary designation won't relieve the other plan fiduciaries of liability – instead (and best case) they would share liability for a breach of that individual's duty. The plan sponsor has no relief from fiduciary risk for adopting the recommendations made by a 3(21) fiduciary.

Implementing a prudent investment selection and monitoring process

As stated above, fiduciaries must act as prudent experts. Let's be clear about what's expected. Prudence does not demand that each investment option in every investment category be constantly switched in search of the best performer. What is expected is that the fiduciaries must define a process to review the plan's investment options and define the criteria used to select the investments.

ERISA requires that every plan provide a procedure for establishing and carrying out a funding policy and method consistent with the plan's objectives. To do this, fiduciaries should create an investment policy statement (IPS) that defines the criteria used to select and monitor the plan's investments.

The monitoring is not exclusive to performance. It also must include the evaluation of many other factors. For example, if a fund does not meet the criteria set forth in the IPS, appropriate action must be taken, which could include replacement of the investment option. Because the fund selection and monitoring processes can be very labor-intensive, it is quite common for a fiduciary to hire an expert to help in defining, implementing, and evaluating the processes. This outside expert can serve as a plan fiduciary, but it is not required.

Documenting the process

Business owners understand the importance and requirement of daily documentation when selling or servicing a product. A 401(k) plan should be treated with the same reverence. In addition to the creation of an IPS, periodic reviews conducted by the fiduciary should be documented with carefully written minutes from the meetings. Minutes should reflect the results of all due diligence completed, as well as any recommendations to replace a fund option.

It is critical that fiduciaries understand their duties and expectations when it comes to working with their company's defined contribution retirement plans.

Understanding your risks and reliefs – and effectively managing them – will help you protect yourself from the ramifications resulting from a breach in duty. ❖

Paul A. Hebert, JD, LLM *Area Assistant Vice President, Compliance Gallagher Benefit Services, Inc. Mr. Hebert is an attorney with extensive experience serving public and privately held clients including governmental and church groups. Mr. Hebert's responsibilities include the design and implementation of retirement plans, conducting plan operational and compliance reviews, and consulting on IRS compliance and ERISA issues. He has lectured, trained and written articles on various employee benefit matters. Mr. Hebert received his Masters in the Laws of Taxation (LLM) from New York University, his JD with Tax Honors from Rutgers University, and his B.A. from Vassar College.*

Michael J. DiCenso, PRP, AIF, LLIF *National Practice Leader, Gallagher Retirement Services and President GBS Investment Consulting, LLC. Mr. DiCenso is the driving force for the GRS team of consultants who help plan sponsors manage their retirement plan process to enable them to mitigate their fiduciary risks. With more than 25 years of experience in the retirement plan arena, he is nationally recognized for his knowledge and insight regarding ERISA, DOL, IRS and fiduciary issues. He earned a BS in Business Administration from Missouri Southern University and holds an LLIF Fellowship from Babson College. In 2008 and 2009, Mr. DiCenso was recognized as one of the "Most Influential" people in the 401(k) industry by 401kWire Magazine.*

Register Now for NCPERS 2010 Public Safety Conference

October 10- 13, 2010
Palm Springs, CA

The Voice for Public Pensions

To register visit: http://ncpers.org/Conferences/PSEP_BC.asp

Early Bird deadline is September 10, 2010

The Voice for Public Pensions

PERSIST National Conference on Public Employee Retirement Systems

Calendar of Events 2010

Public Safety Conference
October 10 – 13, 2010
Hotel Zoso
Palm Springs, CA

Legislative Conference
January 30 – February 1, 2011
Hyatt Regency Capitol Hill
Washington, DC

Trustee Educational Seminar (TEDS)
May 21 – 22, 2011
Fontainebleau Resort
Miami Beach, FL

Annual Conference & Exhibition
May 22 – 26, 2011
Fontainebleau Resort
Miami Beach, FL

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444 North Capitol St., NW Suite 630
Washington, D.C. 20001

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