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## CORRESPONDENCE MEMORANDUM

**DATE:** April 24, 2012  
**TO:** Group Insurance Board  
**FROM:** David H. Nispel, General Counsel  
**SUBJECT:** Board Members: Ethics and Fiduciary Duty

**This memo is for informational purposes only. No Board action is required.**

This memorandum will provide an overview of the ethics and fiduciary duties of Board members. Board members are encouraged to use the memorandum as a reference source and supplement to the Governance Manual.

### 1. Wisconsin Retirement System (WRS) and Board Responsibilities

- The WRS and related benefits are governed by Chapter 40 of the Wisconsin Statutes. Board members should become familiar with and recognize their statutory responsibilities.
- Health insurance and life insurance contracts.
- Review the Governance Manual for additional information.

### 2. Fiduciary Defined

- A fiduciary is one who holds assets in trust or in confidence for a beneficiary. A person is a fiduciary with respect to a pension plan to the extent they have discretionary authority to the plan and assets. The exercise of discretion and control, or the authority to do so, are the keys to making this determination. Trustees are clearly fiduciaries, but benefits administrators are too. The courts have held that one who designs, recommends, and implements a pension plan is a fiduciary.

### 3. Who Are Fiduciaries?

- All Board members (trustees) are fiduciaries.
- Some advisors may be fiduciaries; some may not.
- Those who have discretion over benefits eligibility are fiduciaries.

Reviewed and approved by Robert J. Conlin, Secretary  
  
Signature  
Date 5/1/12

Board	Mtg Date	Item #
GIB	5.22.12	1A

- Some internal Employee Trust Funds (ETF) staff are fiduciaries; some are not.
- The test is whether a staff person has discretion and control over the administration of the plan or management of the assets.
- A person's fiduciary duty is limited to the scope of responsibility they assume.

#### **4. How Does One Become a Fiduciary?**

- By accepting a position on a Board covered by a state statute naming fiduciaries.
- By assuming certain responsibilities, even if not required by the statute.
- By agreeing to fiduciary standards in a contract.

#### **5. Fiduciary Duties**

- Duty to ensure premiums are paid by employers and/or employees.
- Duty to pay benefits: the correct amount, on time, and to the right person.
- Duty to comply with plan documents.
- Duty to comply with laws and regulations (state and federal).
- Duty to inform members.
- Duty to defray the expenses of administering the system in a reasonable manner.
- Duty of loyalty to trust fund participants.
- Duty not to use position for personal gain.
- Duty to act solely in the members' interest for the exclusive purpose of providing benefits to participants and their beneficiaries.
- Duty to act prudently.
- Duty to hire experts.

#### **6. Guidance for Fiduciaries**

- Federal and state laws.
- Attorney General opinions.
- Court decisions.
- Advice of legal counsel.
- Best practices of public retirement systems.

#### **7. Prudent Expert Standard**

- Trustees will be judged by those who serve in the same capacity as them and who act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with

such matters would use in the conduct of an enterprise of like character and with like aims.

**8. Exercising Prudence**

- If trustees are not experts, they are to carefully hire, monitor, and evaluate the experts they rely on.
- Experts exist inside and outside the organization.
- Questioning experts is not impolite.
- Trustees must “do the right thing” while incurring only reasonable expenses.

**9. Delegation and Interpretation of Prudence**

- Delegation.
  - Delegation of responsibility is allowed; abdication is not.
  - Carefully select those working for you.
  - Monitor them regularly.
  - Trustees are protected if they act prudently in delegating duties.
- Interpretation.
  - Use current standards, not outdated ones.
  - Consider what is going on nationwide.
  - Focus on public retirement systems.
    - Follow the very best practices.

**10. Prudence in Action**

- In Benefits Administration.
  - Accurately interpret the law and policies.
  - Carefully determine benefits and distribution eligibility.
  - Maintain confidentiality of certain information.
  - Protect the tax-qualified status of the trust.
- In Operations.
  - Respect open meetings and open records laws.
  - Disclose whatever personal information is required.
  - Uphold the ethics policy.
  - Respect your internal operations policies.

## 11. Duty of Loyalty

- Fiduciaries are to act solely for the benefit of the beneficiaries.
- This means current and future beneficiaries.
- When creating policies or making other decisions, the fiduciaries can only “wear one hat”. The law is very strict about this.

## 12. The “Two-Hat” Rule

- What about trustees who are also:
  - Plan sponsor or employer representatives.
  - Elected or appointed representatives of member or retiree constituencies.
  - “Ex officio” elected officers.
- Not precluded from serving as a trustee because of dual status.
- No fiduciary duty is owed to the appointing Board.
- No fiduciary duty is owed to a sub-group of “constituents”.
- Maintaining a good working relationship with them is wise; however, the fiduciary duty to the current and future beneficiaries of the fund is paramount to all other duties or obligations.
- May only wear one “hat” at a time.

## 13. Impact of Two-Hat Rule

- MUST wear fiduciary “hat” when making fiduciary decisions.
- Ultimately, trustee must make decisions solely on what is in the best interests of members, retirees, and beneficiaries.
- Should ask how decisions will impact plan participants.
- Should raise open, honest discussion on these questions during meetings.
- Should consider recusal if:
  - Trustee can’t help but be influenced by other “hat”.
  - Appearance of conflict is too strong to overcome.

## 14. Conflicts of Interest

- Avoid self-dealing.
- Avoid self-enrichment.
- Personal financial gain from the fund is prohibited.
- Reputational enhancement by using your status with the fund is to be avoided.

- Courts are very strict on fiduciaries.
- The “court of public opinion” is very strict as well.

**15. Cofiduciary Liability**

- Cofiduciary liability means “you are your brother’s keeper”.
- If you know of a violation and do nothing about it, you are breaching your fiduciary duty.

**16. Protection From Liability**

- Protection.
  - By relying on “experts” (not always).
  - By governmental immunity (maybe, for some actions).
  - By fiduciary insurance (to a limited extent).
- Indemnification for damages.
  - The state will pay any “excess damages” awarded in proceedings against a Board member who is sued in his or her official capacity or for acts committed while carrying out Board duties and the court or jury finds that the Board member was acting within the scope of employment.
  - Excess damages are those that exceed any applicable insurance coverage of the Board member.
- Legal representation.
  - The state will defend a Board member sued for acts committed while carrying out Board duties.
  - Generally, this representation will be provided by the Attorney General.
  - If the Board member refuses the state’s offer of legal counsel and hires outside counsel of his or her own choice, then the Board member is not entitled to reimbursement for the expenses and costs of that representation.
- Avoidance.
  - Orientation and continuing education.
  - Thorough decision-making processes.
  - Clear documentation of Board actions.
  - Expert advice in certain areas - law, actuarial issues, audits, technology.
  - Good governance and ongoing oversight activities.

**17. Conclusion**

- Fiduciary standards are very high.
- When times are tough, Boards are more closely scrutinized.
- Careful, thorough, and scrupulous behavior is expected.
- A good process is very important to a good outcome.
- Your members and beneficiaries expect you to meet and maintain fiduciary standards.
- Conduct open and public meetings in accordance with applicable law.
- Process, Process, Process.

**SELECTED STATUTORY RESPONSIBILITIES  
GROUP INSURANCE BOARD (S. 40.03 (6), STATS.)**

- Shall enter into contracts with one or more insurers for the purposes of providing group insurance plans.
- May provide any group insurance plan on a self-insured basis.
- May provide other group insurance plans for employees and their dependents and annuitants and their dependents.
- May take action to carry out the purpose and intent of the group insurance plans provided under ch. 40, Stats.
- Shall not enter into agreements to modify or expand group insurance coverage which conflicts with ch. 40, Stats., or rules, or materially affects the level of premiums required to be paid or the level of benefits to be provided.
- Shall offer long-term care insurance policies.
- Shall accept timely appeals of Department determinations affecting any right or benefit under any group insurance plan provided under ch. 40, Stats.
- May contract for data collection and analysis services related to HMOs and insurance companies that provide health insurance to state employees.