Wisconsin Employee Trust Funds

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# Fiduciary Responsibility

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# Agenda

- Employer vs. Fiduciary Functions
- Fiduciary Capacity
- Identifying Plan Fiduciaries
- Fiduciary  Duties and Oversight Responsibilities
- Fiduciary Standards of Conduct
- Fiduciary Best Practices
- Tips for Limiting Fiduciary Liability

# Employer Functions vs. Fiduciary Functions

- Employer functions, also called settlor functions, are actions or decisions made by the employer as the employer.
- Employer, not plan fiduciary,  functions include:
  - Establishing the retirement plan.
  - Designing the plan's benefits and features, such as the benefit formula, eligibility rules and vesting.
  - Amending the plan provisions.
  - Terminating the plan.
- Settlor functions are not an exercise of fiduciary discretion and thus not subject to fiduciary duties and standards.
- Keeping settlor functions separate from fiduciary functions is very important.

# Fiduciary Capacity and Identifying Plan Fiduciaries

# What is Fiduciary Capacity?

- This question gets right at the heart of what constitutes fiduciary capacity and when it attaches to an individual.
- A person acts in a fiduciary capacity when he or she 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 with respect to the plan and assets.
- The exercise of discretion and control or the authority to do so are the keys to determining who is a fiduciary.
- Fiduciary responsibility arises every time the Board, or certain designated employees, make decisions that impact the plan and plan assets.

# Importance of Knowing Who is a Fiduciary

- Responsibilities of plan fiduciaries are many and not to be taken lightly.
- Fiduciaries are held to the highest standard of conduct under the law.
- Board members or staff members who don't know they are fiduciaries may inadvertently breach their fiduciary duty.
- A sound fiduciary governance process:
  - Protects participants' benefits, and
  - Effectively shields the employer, Board members and other fiduciaries from liability.

# Who is a Plan Fiduciary?

- Fiduciary status is based on functions performed, not a person's title.
- Anyone who takes discretionary action to manage and administer the plan or exercise control over plan assets.
- All Board members (trustees) are fiduciaries:
  - 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
- Other administrative plan fiduciaries may include:
  - Committees,
  - Attorneys,
  - Actuaries, and
  - Plan's administrative staff.

# Who is a Plan Fiduciary?

- Some internal 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.
  - Plan fiduciaries include Matt Stohr in his role as Administrator, Division of Retirement Services, WI Dept. of Employee Trust Funds, and Bob Conlin, ETF Secretary.
- Third party experts are typically <u>not</u> fiduciaries.
- Advisors who have discretion over plan administration or assets are fiduciaries.
- Identify all parties who work on the plan and determine whether they are exercising discretion over the plan when performing their duties.
- Note: SWIB members are fiduciaries as are any investment advisers to provide investment advice to the SWIB for a fee.

# Fiduciary Duties and Oversight Responsibilities - § 19.48

# Pension Fund Governance and Oversight

- The fund functions within a framework that is comprised of statutes, rulings, court decisions, agreements, policies and contracts that regulate system operations.
- Your fund's governance structure is comprised of its board(s), committees, executive management, functional staff and contracted experts.
- The Board sets strategy, approves implementation plans and oversees performance and risk.
- The Board delegates specialized functions such as legal review, benefits administration and auditing to internal committees, staff and contracted experts.
- Risk oversight and managing reputation risk is a key responsibility of the board.

# ETF Board Fiduciary Responsibilities – Governance Manual

- Each ETF Board member is a trustee with all powers necessary and appropriate for the carrying out of the trusts' purposes.
- Fiduciaries are personally liable to make good to the pension plan any losses from breaching their fiduciary responsibility.
- Duties you perform with your "fiduciary hat" on include the duty to:
  - Collect contributions from employers and/or employees.
  - Pay benefits: the correct amount, on time, and to the right person.
  - Ensure the Wisconsin Retirement System complies with qualified plan rules under the Internal Revenue Code.
  - Comply with plan documents.
  - Comply with laws and regulations.

# ETF Board Fiduciary Responsibilities – Governance Manual

- Duties you perform with your “fiduciary hat” on include the duty to:
  - Hire experts, including an actuary or an actuarial firm.
  - Approve the tables to be used for computing benefits.
  - Appoint the Secretary of the Department.
  - Accept and hear timely appeals of determinations of the Department.
  - Require employers to distribute materials necessary for fund administration.
  - Delegate powers as desirable or necessary.
  - Approve or reject administrative rules proposed by the Department Secretary.
  - Allow separate retirement plans to send funds to the Department for investment in the Core or Variable Retirement Trust Funds.
  - Transfer funds to provide group insurance.

# Teachers Retirement Board (S. 40.03(7), STATS. and Wisconsin Retirement Board (S.40.03(8), STATS. (Plan Document)

- TR and WR Boards advise the ETF Board on retirement system matters specific to the groups they represent .
- TR and WR Board fiduciary responsibilities include the duty to:
  - Appoint four members to the ETF Board.
  - Study and recommend alternate administrative policies and rules that will enhance achievement of objectives of the benefit plans.
  - Appoint one member to the State of Wisconsin Investment Board.
  - Approve or reject all administrative rules that relate to teachers (TR Board) or non-teacher members (WR Board) of the WRS.
  - Authorize, hear appeals and terminate disability benefits to teachers (TR Board) or non-teachers (WR Board).

# Fiduciary Standards of Conduct

# The Laws that Apply to Fund Fiduciaries

- Federal law - IRC and regulations governing public pension plans.
- The Employee Retirement Income Security Act of 1974 (ERISA).
- Wisconsin statutes – for example, Subchapter III of Chapter 19 – General Duties of Public Officials contains the Code of Ethics for Public Officials and Employees
  - § 19.45 Standards of Conduct
  - § 19.46 Conflicts of Interest Prohibited
  - § 19.48 Duties of the Board
  - § 19.59 Code of Ethics for Government Officials, Employees and Candidates
- Governance Manual For the Employee Trust Funds, Wisconsin Retirement and Teachers Retirement Boards

# Fiduciary Standards of Conduct

- Failure to meet fiduciary obligations can result in severe penalties, including personal liability.
- Participants continue to sue plan sponsors for alleged breaches of fiduciary duty.
- Basic fiduciary principles under ERISA and state law:
  - Duty of loyalty
  - Duty of prudence
  - Duty to monitor experts and make changes when warranted
  - Duty to follow terms of plan documents



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# Duty of Loyalty

- The duty of loyalty is called the exclusive benefit rule:
  - Act solely in the best interests of the beneficiaries of the Fund,
  - Act for exclusive purpose of providing plan benefits, and
  - Ensure plan fees and expenses are "reasonable."
- Fiduciaries cannot put individual or personal interests before those of the plan and participants.
- Board members must represent all participants in the WRS, not just their particular association or sub-group of "constituents" (e.g., teachers or police).
- Board membership includes the fiduciary responsibility of protecting the trust funds to help assure funding for the future retirement benefits of all current active employees.

# Duty of Loyalty

- Avoid Conflicts of Interest at all costs:
  - 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.
- Wisconsin Statutory Standards of Conduct – Governance Manual – Loyalty:
  - Duty to act solely in the members' interest for the exclusive purpose of providing benefits to participants and their beneficiaries.
  - Duty of loyalty to trust fund participants.
  - Duty not to use position for personal gain.
  - Duty to defray the expenses of administering the system in a reasonable manner.

# Prudent Expert Standard and Exercising Prudence

- Trustees must act with the care, skill, prudence, and diligence a prudent person acting in a like capacity and familiar with such matters would use.
- In other words, plan fiduciaries must act with the careful good judgment a knowledgeable person administering a public pension plan would use.
- Prudence is one of the most important duties because it comes into play in every activity undertaken by the fiduciaries.
- Duty of prudence is required under your Governance Manual.
- Trustees must "do the right thing" while incurring only reasonable expenses.
- "Reasonable" generally not defined.



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# Duty of prudence – Standard of Care

- Duty of prudence is more than just an obligation to be competent and careful – it focuses on following sound processes when making fiduciary decisions.
- A prudent decision-making process entails:
  - Gathering, examining and giving appropriate consideration to relevant information.
  - Implementing the decision.
  - Periodically monitoring performance to ensure the decisions continue to be right for the plan, and
  - Keeping good records of your deliberations and decisions.
- If trustees are not experts, they are to carefully hire, monitor, and evaluate the experts they rely on.
- Experts may come from inside and outside the organization.

# Monitor Experts

- Supreme Court ruling in Tibble vs. Edison validates duty to monitor:
  - The role of a fiduciary is active, not passive.
  - Monitoring is part of procedural prudence .
  - The duty of prudence involves a continuing duty to monitor.
- Establish a process for reviewing each expert's performance with respect to services set out in the contract .
- Monitor fees to ensure they are reasonable.
- Change experts when necessary to promote the best outcomes for participants.
- Keep adequate records to document the evaluation and decision-making process used in monitoring experts and the basis for your decision to retain them or make a change.

# Know Your Plan Document and Operate the Fund Accordingly

- Governance manual requires that you understand and comply with the plan documents and governing statutes.
- Plan documents must comply with Internal Revenue Code and regulations.
- Plan document must describe each feature you are offering participants – it is your contract with the participants.
- Read the plan document thoroughly to be sure you understand each provision.
- The plan document is your manual for administering the plan.
  - Compare plan policies, procedures and forms to the terms of the document.
  - Revise any procedures that do not exactly match the document.
- Failure to operate the plan in compliance with governing documents is a top IRS audit “catch-all” and can cause the plan to become disqualified.

# Fiduciary Best Practices

# DB Plan Best Governance Practices

- Governance Manual
- Board Practices
- Board Policies
- Risk Oversight
- Strategic Planning
- Stakeholder Communications

# Governance Manual for ETF, WR and TR Boards

- Governance Manual contains fund's primary governance documents and provides a tool to educate trustees and stakeholders on fund operations.
- Key components include:
  - Meeting Dates and Employee Trust Funds' Key Contacts
  - Organization and Responsibilities of Boards
  - Board Member Commitment Overview
  - Retirement Board – Quarterly Base Agendas and Board Rosters
  - Board Committee Charters
  - The Secretary's Role
  - Employee Trust Funds' Functional Organization Chart and Fact Sheets
  - Ethics and fiduciary Duty
  - Legislation
  - WRS Funding
  - Board Policies

# Board Practices - Regularly Scheduled Board Meetings

- Joint meetings of the ETF, WR and TR Boards are held quarterly to hear from various committees and to discuss and make decisions for the plan.
- Include all plan fiduciaries and any staff or third parties needing to provide information to the Board.
- Key things to document in meeting minutes include:
  - Identity of all persons in attendance.
  - Prominently highlight the prudent process followed at the meeting.
  - Focus on decisions reached at the meeting.
  - Incorporate reports from third-party advisers maintain as part of the minutes.
  - Emphasize advice provided by third-party advisers and legal counsel.
- Draft the minutes timely and ask all attendees to approve them.

# Board Policies

- A fund should adopt and follow a set of policies designed to guide operations, including standards of conduct, ethics and conflicts of interest rules.
- Your board's key policies and procedures include:
  - Board Member Compensation and Reimbursement Policy (adopted 12/11/14)
  - Board Member Qualification Policy (adopted 12/11/14)
  - Board Public Notice Protocol (adopted 8/13/09)
  - Communications Policy (adopted 12/3/09)
  - Conflict of Interest Policy (adopted 3/18/10)
  - Conduct of Board Meetings Policy (adopted 3/18/10)
  - Vendor Procurement Appeals Policy (Revised 9/25/14)
  - WRS Funding Policy (adopted 12/11/14)
- Board policies will be added as they are adopted by the ETF Board
  - Perhaps consider a privacy policy setting out procedures for protecting members' confidential data if not already in place.

# Risk Oversight

- A fund should adopt a risk management framework and document it.
- Your Audit Committee is charged with assisting the Board in fulfilling its fiduciary and oversight responsibilities including the:
  - Financial reporting process,
  - System of internal control, and
  - Department's process for monitoring compliance with laws and regulations and the Institute of Internal Auditors code of conduct.
- The membership and authority of the Audit Committee is set out in your Governance Manual.



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## Strategic Planning

- A fund should adopt a strategic planning approach either in the form of a multi-year plan or within other documents.
- Your Budget and Operations Committee assists the Board in fulfilling its fiduciary and oversight responsibilities with respect to strategic planning by reviewing the:
  - Budget process and the Department's budget request;
  - Department's strategic business and information technology planning activities;
  - Department's operational activities.
- Key responsibilities include reviewing and offering recommendations to the Board and Secretary on the Department's:
  - Strategic business plans, including service goals and benchmarks and information technology plans.
  - Operational policies such as continuity of operations and disaster recovery.
  - Monitoring progress in meeting strategic business plan goals and benchmarks.

# Stakeholder Communications

- A fund should communicate regularly with members and other stakeholders through multiple media including web site notifications, publications and letters as well as required reports.
- Communications provide transparency into fund operations and may increase member satisfaction, while strengthening the fund's reputation.
- Your Governance Manual imposes a duty on the ETF Board to inform members.
- You have a variety of pieces intended to educate members on various aspects of the Fund.

# Tips for Limiting Fiduciary Liability

# Separate Employer Functions from Fiduciary Functions.

- Important to keep settlor functions separate from fiduciary functions.
- A fiduciary making a settlor decision may turn a non-fiduciary action into a fiduciary action.
- A Board performs both settlor/employer functions and fiduciary functions should hold separate meetings for each function.
- Do not include design or settlor functions in administrative Board minutes where the administrative committee is the fiduciary for the plan.
- This a frequent issue for Boards and committees and this fairly simple step will substantially minimize the Board's fiduciary liability.



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# Defined Benefit Plan Lawsuits

- Maintaining the separation of settlor and fiduciary functions is critical in recent lawsuits.
- Public pensions have been sued for attempting to “cut back” plan features , such as:
  - Raising the retirement age.
  - Suspending cost-of-living (COLA) adjustments.
  - Shifting employees from a defined benefit plan to a hybrid defined benefit-defined contribution plan.
  - Changing the structure of contributions.
- So long as these settlor functions are clearly done with the employer’s hat on, not as fiduciary functions, then liability is substantially reduced.

# Fiduciary Review

- The purpose of a review, either a self-audit or one by an independent expert, is to help improve the capabilities of a fund using a structured approach to:
  - Provide independent reassurance to key stakeholders that the trustees are fulfilling their fiduciary duties and that the fund is well run;
  - Evaluate current policies and practices and compare them to leading practices;
  - Identify strengths and opportunities for improvement; and,
  - Identify implementation options.
- Fundamental questions addressed by fiduciary reviews include:
  - Are we meeting our fiduciary responsibilities?
  - How well are we managing potential conflicts of interest?
  - Are governance processes working as well as they can/should?
  - Do we have the most appropriate policies and practices?
  - Where can we improve? How can we be more effective and efficient?
  - What is best for our fund and beneficiaries, given our current stage of development?




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# Demonstrate Fulfillment of Fiduciary Duties

- This is extremely important. The court's emphasis is on the process of fiduciary decision making, not the result. This is generally called procedural prudence.
- The bottom line is document, document, document. Generally, on our governance reviews we see poor and incomplete documentation. You should create detailed committee minutes that:
  - Point out discussions.
  - Set forth recommendations of experts and other third parties.
  - Reflect decisions and reasoning.
- Retain documents used at meetings and meeting minutes.



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# Fiduciary File Cabinet

- Maintain a fiduciary file cabinet to document Board's systematic processes and evidence that good processes were followed.
- Board and committee minutes are a critical components of the file cabinet.
- A complete set of all current signed plan documents:
  - Plan documents and summary plan materials,
  - Trust agreement,
  - Plan forms, rules and procedures,
  - Service agreements,
  - Third party experts' contracts, and
  - All amendments to those documents.

# Thank You!
# Questions?

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