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Gary W. Findlay, Series Editor

The Legal Obligations of Public Pension Plan Governing Boards and Administrators

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Foreword

Since 1965, the Government Finance Officers Association (GFOA) has published a series of handbooks designed to provide a thorough understanding of retirement system management for public retirement administrators, public officials, and all others connected with the operation of public employee retirement systems. These handbooks were conceived by the GFOA's Committee on Retirement and Benefits Administration and many of the committee's members participated in their design and production.

The committee's ongoing concern about the need for timely and accurate information regarding public retirement and benefits administration led a subcommittee, headed by Alfred Bricker, then the executive secretary of the Wayne County Employees Retirement System, to recommend that the association publish a series of monographs on current topics in public retirement and benefits administration. Each monograph in the series addresses a single major topic in public retirement system administration and provides substantive text and examples. Up to ten monographs will be published, each of which will be free standing or which may be combined with other monographs to form a comprehensive body of literature on the practical aspects of public employee retirement and benefits administration.

Public pension fund assets are expected to top the $1 trillion mark before the turn of the century. According to U.S. Bureau of the Census statistics, during the last decade the active number of participants in state and local government retirement systems has grown by one million people, bringing total active participants in 1988 to 12.9 million. The number of beneficiaries also grew by one million between 1977 and 1988 to 3.7 million. However, after the year 2000 the rate of beneficiary growth will far outstrip that of new participants, creating fiscal challenges for policymakers.

Responsible for the stewardship of these funds are the plans' trustees and administrators. Fiduciary standards are deeply rooted in our common law and expressly defined by federal, state and local legal strictures. Diligence is required not only in the investment of plan assets but also in the setting and delivery of benefits. A central skill that all administrators and trustees must master is understanding their fiduciary responsibility to the plan's participants. This monograph has been prepared to assist fiduciaries in meeting this challenge.

The GFOA is pleased to present "The Legal Obligations of Public Pension Plan Governing Boards and Administrators," the fifth in the monograph series. This monograph was written by Lawrence A. Martin, Executive Director, Minnesota

Legislative Commission On Pensions and Retirement. Martin, a pension attorney, has spent the better part of 16 years working in the area of public pensions and previously was the Executive Director of the Pennsylvania Public Employee Retirement Commission. The project was coordinated by Cathie Eitelberg, Director of GFOA's Pension and Benefits Program.

GFOA is grateful to the following individuals for reviewing the draft of this monograph and for their valuable suggestions: Thomas R. Anderson, Executive Director, State of Ohio, School Employee Retirement System; Richard Koppes, General Counsel, State of California, Public Employee Retirement System; Nancy Williams, Deputy Executive Director/General Counsel, State of Colorado, Public Employee Retirement Association. The word processing skills of Jean Liebgott of the Minnesota Legislative Commission contributed greatly to the success of this project. A special thanks goes to Gary Findlay, Consultant, Gabriel, Roeder, Smith and Company, for acting as technical editor for the series as well as serving on the review committee for this monograph.

Jeffrey L. Esser
Executive Director
January 1991

I. Introduction

There are estimated to be over 8,000 public employee pension plans in the United States, including some of the largest pension plans in the country as determined on the basis of the number of participants, the amount of assets and the extent of actuarial liabilities.

For many public pension plans, the administration is not done on a contract basis by external plan administrators, but rather is vested typically in a governing board with one or more plan administrative personnel. These governing board members and plan administrative personnel have undertaken a number of special, and potentially confusing, legal duties, obligations and responsibilities.

This monograph is intended to assist public pension plan governing board members, plan administrative personnel and other interested parties in understanding the source of these obligations, duties and responsibilities, their specific nature and content, and the available strategies to respond to them and to eliminate or reduce the liability or the application of other remedies in the event of a departure from them.

The monograph is divided into six sections. Section I is this introduction. Section II identifies the various sources of the legal obligations for public pension plan governing boards and administrators, which are federal law, state law, local law, administrative and plan rules, and the common law. Section III discusses the differences that exist between a public pension plan and a public pension fund, as well as between a public pension plan and a public pension system. It also discusses the differences between public and non-public pension plans, insured and uninsured pension plans, defined benefit and defined contribution pension plans, and single employer and multiple employer pension plans. In addition, it discusses the differences in the potential legal status of a public pension plan, fund or system. Section IV identifies and discusses the various specific responsibilities and liabilities of public pension plan governing boards and administrators, drawing distinctions in the responsibilities related to pension plan benefits, pension plan funding, pension fund investing, and pension plan administration activities other than pension fund investing. Section V discusses potential protection for public pension plan governing boards or administrators from liability or the enforcement of remedies regarding public pension plan activities, including strategies for the reduction of liability, the role of liability insurance and indemnification, potential defenses against liability or other remedies and the potential for minimizing liability. Section VI is the conclusion.

Credit should be given to Robert W. Weld, an attorney with an interest in pension issues, for his May 30, 1987 presentation to the GFOA Committee on Public Employee Retirement Administration and accompanying materials, which functioned in many ways as a broad outline and a point of departure for this monograph.

II. Sources of Legal Obligations for Public Pension Plan Boards and Administrators

A. Introduction

Public pension plans are direct or indirect creatures of law and are charged with functions that will result in the plans coming into controversy with members, beneficiaries, governmental officials or the general citizenry. Thus, by virtue of these functions and that context, the governing boards and administrators of public pension plans have numerous legal obligations. In attempting to understand these obligations, it is useful to identify their source and to review the particular nature and development of those various sources of legal obligation and their application to public pension plans. These legal obligation sources are constitutional law, statutory law, administrative rules or related regulation, and Anglo-American common law.

B. Federal and State Constitutional Law

1. *In General.* The basic sources of legal power and limitations in the federal system of the United States are the United States Constitution and the constitution of the particular state in which the public pension plan is located. As governmental entities or instrumentalities, public employee pension plans are governed by, subject to or affected by provisions of federal and state constitutional law.

2. *Federal Constitutional Law.* Directly or indirectly, public employee pension plans are impacted by provisions of the federal Constitution. Obviously, federal governmental pension plans as federal governmental entities are very specifically impacted by the federal Constitution. State and local governmental pension plans are decentralized governmental entities in a federal system and are less explicitly referenced in federal constitutional provisions, although equally impacted.

   When the Constitution of the United States was drafted and ratified in the late 1780's, employer established or maintained pension plans in anything like the current configuration were unknown. However, as components of government, public employee pension plans have an essentially governmental character and are subject to the specific requirements and various limitations in the federal Constitution. For federal governmental pension plans, all applicable provisions of the federal Constitution apply. For state and local governmental pension plans, the Fourteenth Amendment on its face, and by virtue of long standing Supreme Court interpretation, the Bill of Rights (first ten amendments) of the federal Constitution is applicable.

The Fourteenth Amendment to the U.S. Constitution, a provision from the late 1860's, applies whenever state action is involved and requires that the state action reflect due process and represent equal protection of the law. The due process requirement has been interpreted by the U.S. Supreme Court since the late 1940's as incorporating the various provisions of the first ten amendments.

As a practical matter, for a public employee pension plan, the due process requirement means that the pension plan must observe various procedural steps with care when an identifiable property right is involved. A public pension plan governing board or plan administrator should assume that entitlement to or access to a public pension is a property right to which the various federal constitutional due process protections apply. While it is beyond the scope of this monograph to explore the specific legal nature of a public pension plan, this an area of public pension law that is still developing. While some states may still hold to the old legal theory that a public pension is a gratuity provided at the discretion of the public employer and is not a property right of the plan member, at least until actual receipt, that legal theory is under general attack and is unlikely to be a successful theory in the future. The plan should operate under the assumption that any public plan entitlement may rise to the level of a property right and must be accorded due process protections. A pension plan will likely comply with the due process requirement of the federal constitution if it has established written procedures for qualifying for benefits, applying for benefits and making benefit determinations and if it observes procedural safeguards, such as decisions made on the basis of a developed record, a right of appeal for adverse decisions with a hearing and a right to have legal representation during that process. The equal protection requirement means that the pension plan must be interpreted and applied in a manner that results in comparable treatment for similar circumstances based on rational classifications.

Thus, for example, the benefit plan document should clearly define what constitutes a disability, as well as all other key elements affecting entitlement for a disability benefit (such as the crediting of service, if a vesting requirement is imposed or the benefit formula utilizes years of service, and age, if a minimum or maximum age provision is applicable), and should set forth the criteria for the disability determination as well as the application procedure (such as the extent of medical evidence required and whether or not an approved leave of absence by the employer or other benefit qualification, such as Social Security, or benefit exhaustion, such as sick leave or short-term disability coverage are required). The plan also should provide for an appeal procedure in the event of an adverse decision, with a review of the decision by a higher or impartial authority, and with an eventual right to a hearing in person with legal representation and an opportunity to present favorable evidence and rebut unfavorable evidence. Disability benefits, if differing in amounts between disabilitants, should be based on differing circumstances that have a direct connection with the disability program, such as the length of service or the extent of the disability on future earning capacity of the disabilitant, and should not be based on undisclosed or discretionary, and potentially arbitrary, factors.

In many states where the view of a public pension benefit as a gratuity has fallen into disfavor, the replacement legal theory frequently utilizes or adopts contract law. The contract theory views a public pension benefit as a contract between the member, the member's employer and the pension plan, either in its own right or as an agent for the employer. If the courts of a particular jurisdiction utilize the contract theory of public pension benefits, then Section 10 of Article I of the federal Constitution will apply. That provision, which prohibits the states from exercising various specific powers, contains a ban on states enacting laws that impair the obligation of contract. Where the contract theory of public pension benefits is the prevailing legal view, a public pension plan governing board or plan administrator must avoid undertaking any action that may result in a diminishment in benefits for those plan members who have a vested contract right. The various jurisdictions that utilize the contract theory of public pension benefits may differ on what aspects of the public pension benefit are included in the contract, when contract rights become vested, and what latitude exists for subsequent contract activities or bargaining to impact on earlier pension benefit contracts. In jurisdictions where the underlying pension plan state legislation grants the plan governing board or administrator little or no discretion or latitude in modifying pension benefits, the vested public pension contract rights issue will affect the applicable legislative body and any pension legislation affecting public pension rights.

3. *State Constitutional Law.* In most jurisdictions, the constitution of the state was adopted before the establishment of any state or local government pension plans. In some states, subsequent constitutional amendments specifically address public pension plan issues, but in most states, the constitution of the state does not address specific pension issues and it is unusual for public pension plans to be explicitly impacted by state constitutional law.

   Like federal constitutional law, state constitutional law will most commonly provide generalized requirements and limitations on governmental action, which are consequently applicable to public pension plan administration because of the plan's governmental connection. Most state constitutions will have due process and equal protection of law provisions. Generally, these will not differ substantially in their interpretation and requirements from those contained in the federal constitution, although in some other areas of social policy, a more restrictive or demanding set of due process or equal protection requirements is being developed in some states based on their constitutions and these requirements may have derivative application to a public pension plan setting. For example, a classification in a civil rights area may be deemed under the prevailing interpretations of federal constitutional law as having a sufficient rational basis, but may not conform with a state supreme court's more demanding interpretation of the application of the equal protection of the law provision of a state constitution and that determination may have a comparable or parallel application in public pension plan administration. The administration of a public pension plan should keep abreast of state constitutional law developments in all areas affecting governmental entities, looking for comparable or parallel situations, and anticipating their application to the public pension plan area.

   Some state constitutions do contain specific constitutional requirements or restrictions applicable to public pension plans. While it is beyond the scope of this discussion to attempt to categorize these provisions in all applicable states constitutions, some provisions can be identified as illustrative of this development. In the States of New York and Illinois, for instance, the state constitution contains a provision prohibiting the diminishment of pension benefit coverage once the coverage has gone into effect. In the Commonwealth of Pennsylvania, the state constitution contains a provision authorizing public pension plan post retirement adjustments that has been routinely interpreted as prohibiting the granting of post retirement adjustments on surviving spouse benefits. In both the State of Michigan and the State of Missouri, the state constitution contains a provision that prohibits the state from imposing a cost obligation on local government without providing the corresponding revenue amount. The provisions have been reportedly interpreted as limiting each state's ability to require the actuarial funding of its local governmental pension plans.

State constitutions also typically specify minimum requirements for the form, style and content of state legislation. If the public pension plan is wholly or largely contained in state law or depends on specific legislative authority, these requirements can have an impact on public pension plan administration. For instance, state constitutions frequently provide that legislative enactments must not include more than one subject. Depending on the attitude of the appeals court or courts of each state, the "one subject" rule may function to invalidate a tag-along pension plan enactment. In the Commonwealth of Pennsylvania, for example, the state constitution contains a "one subject" rule that has been interpreted to invalidate similar provisions affecting different levels of government or different classes of pension plans joined in a single enactment, such as the comparable modification of the investment authority of borough police pension plans and of borough general or nonuniformed employee pension plans, because different prior statutory source legislation is involved.

C. Federal, State and Local Statutory Law

1. *In General.* Public employee pension plans are directly or indirectly impacted by various federal and state laws. If the public pension plan is a local government pension plan, the plan may additionally be subject to a variety of local law provisions.

2. *Federal Statutory Law.* Since World War II, paralleling the growth in the number of public and private sector pension plans in the United States and the value of their benefit coverage, there has been a substantial increase in federal law governing pension plans. The primary focus of this federal legislation has been private sector pension plans, but a significant body of federal legislation affecting public pension plans has emerged.

   The following are the primary federal legislative enactments affecting public pension plans as of mid-1990, with a brief description of the content of the regulation provided by each:

   - *Employee Retirement Income Security Act (ERISA).* The 1974 ERISA enactment, with numerous subsequent amendments, largely applies to private sector pension plans and generally exempts governmental pension plans. The regulation applicable to private sector plans contains a number of items. The private sector pension plan provisions include:
     1) minimum participation standards;
     2) minimum vesting requirements;
     3) limitations on benefit accrual differentials;
     4) maximum benefit amounts;
     5) minimum and maximum funding;

6) minimum fiduciary responsibility standards;
7) minimum reporting and disclosure requirements; and
8) mandatory federal plan termination insurance.

The regulation applicable to public pension plans largely relates to dollar and percentage limitations on pension benefits and contributions involving tax-qualified pension plans.

- *Internal Revenue Code.* The Code, including the 1986 Tax Reform Act, chiefly governs the taxability of pension benefits payable from a pension plan, the tax deductibility of employer contributions to a pension plan, and the taxability of income to a pension trust. The Code applies to public pension plans, with tax qualification generally based on pre-ERISA standards, and also applies to related benefit programs, such as governmental deferred compensation plans and employer "pick-ups" of member contributions. The Code also governs the tax exempt status of pension plans that have a separate corporate existence from the sponsoring governmental entity, such as local police, fire, and teacher pension plans in Minnesota, and the ability of governmental employers to issue tax-exempt debt securities for pension costs and liabilities, such as occurred in Portland, Oregon in the mid-1980's.

- *Age Discrimination in Employment Act.* The ADEA prohibits or limits the application of mandatory retirement provisions and restricts other age-based or age-related pension plan and benefit practices. For most public employees, mandatory retirement provisions are prohibited. Exceptions exist for pre-existing public safety employee mandatory retirement provisions, some tenured higher education faculty members and some high level policy makers.

- *Equal Employment Opportunity Legislation.* The EEO legislation limits various employment and related benefit practices that potentially differentiate for various protected groups.

- *Social Security Act.* The Social Security Act, including Medicare, governs the coverage by and benefits paid from the various Social Security programs and the contributions payable to the Social Security trust funds. For governmental employers, Social Security coverage other than Medicare for post-March, 1986 hirees is not mandatory, and certain employment categories may be exempt depending on state-specific provisions of the Social Security Act and individual agreements between the states and federal government. Once Social Security coverage has been extended to a public employee category, the coverage decision cannot be revoked.

- *Comprehensive Omnibus Budget Reconciliation Act.* COBRA governs the extension of certain employment health and welfare benefit coverages to terminating and similar former employees and dependents and mandatory Medicare coverage for newly hired public employees after March, 1986 who do not regularly have Social Security coverage.

A significant portion of this primary federal legislation is discussed in detail in a Public Pension and Benefits Consortium publication, *The Federal Taxation of Public Employee Retirement Systems: A Handbook for Public Officials,* by Dr. Joseph Metz. Plan trustees and administrators interested in gaining a fuller appreciation of the applicable federal legislation should be aware of that GFOA publication.

Other federal legislation that is not specifically directed at public and private sector pension plans may also impact the operation of public pension plans. The extension of public pension coverage to National Guard personnel and the limitation on public pension coverage to enrollees under federal jobs training programs may also be affected by federal law. The insurability by the Federal Deposit Insurance Corporation of bank deposits made by a public plan is governed by federal law and regulation. Various banking, securities and postal laws also apply to activities in which pension plans may be involved. If criminal activity is involved, various federal fraud and theft statutes may apply.

3. *State Statutory Law.* The primary source of legal obligations for most public pension plan governing boards and administrators is state statutory law. The state statutory law creating these legal obligations can be specifically oriented and applicable to the individual public pension plan, to public pension plans generally, or both, or it can be generally applicable legislation relating to a variety of pension and non-pension entities and organizations.

In state statutory law specifically related to public pensions, there will be a particular regulatory scheme. In creating public employee pension plans, akin to the situation of other administrative and similar agencies, state law delegates some authority that the legislature could otherwise exercise. The delegation of policy-making power can range from a broad delegation to a narrow or minimal delegation. State law can be direct, with the state law actually setting forth the operative provisions without necessitating substantial further specification, or indirect, with the state law delegating to the pension plan governing board or other applicable authorities the ability or responsibility to specify the actual operative benefit and related provisions. The state law governing state or local pension plans will substantially or in the main follow one regulatory scheme or the other, although some mixture of the two schemes may well occur. Also, one regulatory scheme may be followed for one set or type of public pension plans with another scheme followed for another, such as a direct regulatory scheme for statewide pension plans and an indirect regulatory scheme for local pension plans. In Minnesota, for instance, the direct regulatory scheme with great statutory specificity is utilized for statewide and major pension plans and the indirect regulatory scheme with little statutory specificity is utilized for the various local volunteer firefighters relief associations and certain other local public safety pension plans. In Pennsylvania, for example, the direct regulatory scheme is used for the two statewide public pension plans, most county pension plans, and most local police pension plans, with the indirect regulatory scheme used for the remaining local pension plans. A legislative attitude can be discerned in the extent of delegation reflected in state law. The regulatory schemes may occur for historical and evolutionary reasons, for financial considerations, for political considerations, as an expression of relative state confidence in the plan management, or for inexplicable reasons. If the regulatory scheme occurs for historical and evolutionary reasons, early established public pension plans will typically be subject to less direct regulation than later established public pension plans. If a pension plan was established at an early time, typically around World War I, the legislature at the time would likely have met less frequently than it does currently, would have had less expertise in the area, and would likely be more willing to entrust the details of plan operation to the plan's governing board. If the regulatory scheme occurs for financial considerations, public pension plans receiving substantial direct state funding typically are subject to more direct statutory regulation than public pension plans without substantial direct state funding. If a pension plan receives substantial direct state funding, especially if that state funding is an automatic function of the plan's actuarial condition and requirements, the legislature would be unlikely to entrust any potential expansion of benefits solely to the plan's governing board. If the regulatory scheme occurs for political considerations, public pension plans applicable to employing units that have difficult or contentious employee relations will more typically be subject to a direct regulatory scheme if the covered employee group is more able to influence the state legislative process. If the plan membership group of a local pension plan has difficulty in resolving pension issues locally, the membership group may leapfrog the local policy-making process through a direct appeal to the legislature and the adoption of the desired plan and benefit provisions in state law. If the regulatory scheme occurs as an expression of relative political or policy confidence, public pension plans that have engaged in actual or perceived misdeeds in the past will more typically be subject to a direct regulatory scheme. If a plan is viewed by the legislature as having mishandled its broad investment authority, experienced disproportionately large or unjustified administrative expenditures, or exceeded its authority to implement a benefit increase, the legislature may curb those perceived abuses by the adoption of more detailed pension legislation. Some regulatory schemes, of course, may demonstrate no clearly discernible purpose or reason.

Specific public pension plan state statutory law can cover the full range with respect to a public pension plan. The full range includes the governance structure and administration of the plan (e.g., size and composition of the governing board, and the qualification of plan administrators or consultants), the funding of the plan (e.g., actuarial valuation method, and major actuarial assumptions and other valuation report contents or applicable contribution rates), the investment of plan assets (e.g., general standard of investment conduct or list of authorized investment securities), the benefits provided by the plan (e.g., vesting period, normal retirement age or benefit computation method), and miscellaneous items (e.g., activities involving other public pension plans, benefit information or plan coverage). Within the range, some areas may be fully developed while other areas may not be. Also, because statutory enactments typically represent an incremental and somewhat chaotic policy-making process, the regulation in one area may not be fully consistent with the regulation in another area.

State statutory law of a general nature also may apply to a public pension plan. This general state statutory law may be directed basically either at corporations or at governmental agencies or subdivisions. Governmental agency or subdivision state statutory law may relate to public employee labor relations, public employee salary limitations, procurement bidding, open meeting laws, privacy of governmental data, governmental record retention, or public official immunity. Corporate state statutory law may relate to state information reporting and filing, entity name, service of process, and the power to sue or be sued. General state statutory law containing other prescriptive or proscriptive provisions relate to workers' compensation, state income taxation, negotiable instruments law, safety and health regulation, and the statute of limitations on legal actions.

In a number of states, there are specific state criminal enactments that apply to public pension plans and their management and membership. Generally, state public pension plan criminal enactments cover false statements that are either made or permitted to be made and that are intended to defraud the pension plan and make these occurrences either a misdemeanor or a felony, and are punishable by a fine, a prison sentence, or both.

4. *Local Government Enactments.* For a number of public pension plans, especially public employee pension plans of wholly or primarily a local character, legal obligations for governing boards and administrators derived from state statutory law are supplemented or modified by local government enactment. The local government enactments can be in the form of a charter amendment, if the local government is a home rule charter subdivision, an ordinance, or a governing body resolution. These enactments can relate directly to the public pension plan, such as the specification of municipal representatives on the plan's governing board, or can be peripheral to the public pension plan by regulating other aspects of the public employment relationship that bear on pension plan coverage, such as a limitation on the receipt of a public pension from a plan supported by the local government while being employed by the same local government.

These enactments may be oriented specifically to the pension plan and directly administrative in nature, such as a requirement that the pension plan administration submit annual budget documents, a requirement that all disability benefit applicants be referred to the medical advisor of the governmental unit for an initial or a concurring medical examination, a requirement that recipients of public pension investment business and the extent of that business be reported, or a requirement that certain types of investments be given a preference or be avoided. Alternatively, these enactments may be applicable broadly to all local government functions, such as local government civil service personnel requirements or travel reimbursement reporting requirements. The local government enactments also may be peripheral to other regulatory efforts or other aspects of the public employment relationship, such as fire code requirements relating to the office space occupied by the pension plan administration or to any local real estate investment property owned by the pension plan, police or fire mandatory retirement provisions that may require notification or enforcement by the pension plan administration, or re-employed annuitant benefit suspension or earnings limitation provisions that may involve enforcement measures by the pension plan administration.

Sometimes a statewide multiple employer pension plan covering local governmental units can be directly or indirectly impacted by local government enactments. Obviously, public health and safety regulations must be followed. More clearly pension-oriented or related local regulation may also apply, such as reemployed annuitant benefit suspension or earnings limitation provisions, which as a practical matter may necessitate pension plan administration cooperation to be effective or may require actions by the public pension plan administration. Whether local regulation of statewide public pension plan administrative officials outside of public health and safety regulation will be enforceable will depend on developed state law and on the extent of intrusion by the regulation in the affairs of the public pension plan.

Incidental local regulation may also create a practical obligation for a local or statewide public pension plan seeking to maintain useful intergovernmental or intragovernmental relationships. An example would be a local government enactment that required accounting for the local government on a generally accepted accounting principle (GAAP) basis, where pension benefit obligations for the governmental unit must be calculated and pension funding requirements applicable to the government unit must be reported. The pension plan administration could assist the governmental unit and include this data as part of the actuarial valuation process. Once the plan does so, however, it may create an expectation or obligation for the pension plan administration to continue to do so.

D. Administrative Rules and Similar Regulation

1. *In General.* When the federal government and most state governments were established, administrative law essentially did not exist and the practice of board delegation by legislative bodies to other governmental entities of the power to make binding and enforceable regulation either was prohibited or was not supported by the state and federal judiciary. However, with the shift in the nature of American life from primarily rural and agricultural to primarily urban and industrial, the consequential increase in complexity in American life, and the increasing reliance on governmental regulation in safety, health, welfare and economic areas, there has been a growth in administrative and related regulation. Not surprisingly, the increasing role of administrative regulation has included public employee pension plans and their administrative officials.

2. *Administrative Agency Regulation.* The regulation adopted by administrative agencies typically has the force and effect of law. Federal, state and local administrative agencies all have a potential role to play in regulating public employee pension plans.

   Of the various federal agencies with regulatory power, the chief agency applicable to public employee pension plans is the federal Internal Revenue Service and the source of significant regulatory obligations for public pension plans are the federal internal revenue regulations. The internal revenue regulations flesh out various aspects of the federal internal revenue code. For the public pension official, the internal revenue regulations govern aspects of the pension plan, such as the filing of 1099 Forms, the filing of certain data on computer accessible tape rather than on a hard paper copy, and the nondiscrimination in benefit coverage tests. Other federal administrative agencies that may impact a public employee pension plan include the Social Security Administration, the Equal Employment Opportunity Commission, the Securities and Exchange Commission and the Department of Labor.

   State agencies also may have direct regulatory power over public employee pension plans and that regulation may raise obligations for pension plan officials. Many states, such as Michigan (Michigan Bureau of Retirement System) and Wisconsin (Wisconsin Department of Employee Trust Funds), utilize a regular state agency to administer one or more of the state's pension plans. Other states, such as Illinois (Illinois Municipal Retirement Fund), Missouri (Missouri Local Government Retirement System), or Pennsylvania (Pennsylvania Municipal Retirement System), utilize a state agency or quasi-state agency to administer local pension plans. These agencies all may generate regulations or rules for their operation and may issue directives for the entities participating in the plan. Other states, such as Minnesota (Minnesota State Board of Investment) or Massachusetts (Pension Reserves Investment Management Board), use a separate state agency to handle public pension fund investments. That separate investment agency may issue formal or informal rules for the transfer of funds for investment and the liquidation of securities to gain needed funds. State treasurers and governmental auditors also may have a regulatory role and may adopt formal or informal rules, as may state departments of labor, state insurance departments, state personnel or employee relations departments and state finance or revenue departments. Formal or informal rulemaking generally makes a difference, since the issuance of rules that are binding on the general public usually must be issued following a structured formal process. However, for public pension plans and their administrative officials, this formal rulemaking procedure requirement usually does not apply, since plans and officials generally are not considered to be members of the public when subject to regulation and will not likely be able to successfully raise procedural objection to the rulemaking process in the event of informal rulemaking (such as guidelines, office manuals, or office procedures), rulemaking shortcuts, or rulemaking exemptions.

Local agency rulemaking is likely to be less significant in scope than federal or state administrative rulemaking, because most local rulemaking is related to public health, welfare and safety, applies broadly, and is widely understood by the public at large.

3. *Internal Plan Regulation.* Internal plan rules, regulations or articles of incorporation and bylaws (if the pension plan takes the form of a corporation) also may play a role in the management of a public employee pension plan. The regulation may run the full range of topics, from substantively oriented items such as disability determination procedures, service crediting requirements and plan membership exemptions or optional membership elections to less pension-oriented topics such as working hours for pension plan personnel, performance evaluations for pension plan personnel and supervisory checks or approvals for pension plan activities.

   Courts will require an administrative agency to follow its own procedures and internal regulation, especially if the internal activity bears on a benefit issue or otherwise affects another person's rights or benefits. For instance, if the plan empowers the plan administrator to determine the occurrence of a disability and, subsequently, a disability benefit applicant is turned down, the applicant may attempt to overturn the determination by challenging the appointment of the plan administrator if the person's hiring violated an internal policy (e.g., the person was not in top specified number of civil service examination finalists, or the person did not have sufficient prior pension administration experience at the time of hiring).

4. *Collective Bargaining Agreements.* While not all public pension plans are subject to the collective bargaining process, if the plan is subject to that process, the collective bargaining agreement may create obligations for plan officials similar to administrative rules. Although the collective bargaining agreement will chiefly apply to the benefit plan and benefit provisions, administrative practices will be impacted or modified by those agreements and will be enforced either through administrative grievance procedures or by litigation.

5. *Administrative Hearings.* Administrative procedures include both the adoption of regulatory provisions and the resolution of administrative issues (contested case proceedings). Administrative hearings may be required, such as the procedures for handling the disallowance of a disability claim, or may be entered into on a voluntary basis, such as the voluntary referral of a service crediting question to an administrative law judge or hearing officer. The substantive result of the administrative hearing generally will be binding only on the specific issue for the parties involved, but also may have application to similar or comparable administrative questions.

6. *Prior Administrative Practice.* Administrative actions, procedures and obligations do not occur in a vacuum. Prior administrative practices will influence and impact current administrative practice and an administrator may not appropriately undertake to interpret some plan provision or administrative aspect without reference to prior administrative interpretations or practices. The administrator has an obligation to record administrative determinations and to consult with the available prior administrative record. The prior administrative practice to be consulted and recorded includes plan administrator interpretations, governing board determinations, and opinions of the plan legal advisor (or state's attorney general, if applicable).

E. Common Law

1. *In General.* A portion of the legal obligations imposed on public pension plan governing boards and administrative officials is a result of common law developments. The common law differs from the previously discussed sources of legal obligation because it encompasses a group of adaptable general principles rather than a specifically binding code of enactments.

2. *The Nature of Common Law Regulation.* The common law predates constitutional, statutory and administrative law and is the foundation of the Anglo-American legal system. Unlike constitutional or statutory law, which entail enactments by special legislative bodies (such as constitutional conventions) or by regular legislative bodies (such as legislatures or general assemblies), and unlike administrative law, which entails supplementary or derivative enactments similar to and with the force and effect of legislative enactments, the common law is law fashioned by the judiciary in the context of resolving specific legal controversies.

   As judicially determined law derived from the accumulated and synthesized resolutions of numerous similar controversies, the common law approaches regulation in a manner directly opposite that of constitutional, statutory or administrative law. The special, regular or quasi-legislative approach attempts to fashion an entire regulatory scheme in a single enactment, with subsequent incremental adaptations, modifications or improvements as needed. The common law process attempts to fashion a resolution for a very particular controversy or conflict and from the accumulated resolutions of many similar controversies or conflicts, to eventually derive general governing principles. Constitutional, statutory and administrative law could be looked at as a top-to-bottom exercise, or as a broad-principles-to-specific-regulation process, while the common law can be looked at as a bottom-up-to-top exercise, or a specific-controversy-result-to-broad-principles process.

3. *The Common Law Relating to Trusts.* The principal common law area giving rise to public pension plan governing board or administrative official legal obligations is the common law of trusts.

A trust is a relationship between two or more persons in which at least one person holds legal title or formal ownership to property for the benefit of another person or other persons. The trust can be created by a person to be effective during the person's lifetime or to be effective at the time of the person's death. The trust can be implied by law or by the court (generally when there is a specific legal duty to be undertaken or when there is a substantial status difference or a significant disparity in ability between parties in a commercial or related activity). The trust also can be created by an organization to underlie a program or benefit structure (such as a public employee pension plan).

The common law on trusts, derived over time largely out of the area of wills and decedent estates, approaches the question of the obligations of the governing body and administrators of a public pension plan (and actual or defacto pension trust) from essentially a defined contribution perspective. Because the item of value transferred under a will or in the resolution of a decedent's estate is typically an amount of money, akin to a defined contribution pension plan, the derived common law of trusts has its clearest application in the context of a public pension plan to the areas of asset investment and authorized disbursements. The common law of trusts has less direct application to the features of a defined benefit pension plan that do not involve investment or expenditure issues. A defined benefit pension plan is the most common form of public employee pension plan in the United States.

The whole body of the common law of trusts has been compiled by the American Law Institute in the *Restatement of Trusts Third.* The emphasis of the common law of trusts can be identified, and that emphasis may be of assistance in understanding aspects of the more particular regulation of public pension plan governing boards and administrators. The common law of trusts looks to the relationship between the trustee and the beneficiary, since the trustee holds the legal title to the assets of the trust and can dispose of those assets without giving notice to or being subject to consultation with the beneficiary, who holds only a non-operational beneficial title to the assets of the trust. The common law of trusts refers to this relationship as a "fiduciary" relationship and requires a high degree of loyalty by the trustee (legal title holder) to the beneficiary (beneficial title holder), since the beneficiary is at an absolute disadvantage when compared to the trustee with respect to the handling of the trust assets. The court will be the referee in determining the fairness of trust activities to the beneficiary, and any unfairness to the beneficiary at the hands of the trustee or by virtue of any inaction by the trustees will likely bring legal liability.

4. *The Common Law Relating to Torts.* The common law of torts also has potential application to public pension plan governing boards and administrators regarding their action or inaction.

As it has developed through the common law, a tort is any civil or noncriminal injury to another resulting from a person's action or inaction when there was a duty to act. Torts can be intentional or negligent. Intentional torts arise from injurious actions that were intended or for which the injurious consequences of the action are readily foreseeable. Negligent torts arise from inaction or insufficient action when a person has a duty to act or has an obligation to perform in a less haphazard fashion.

In a public pension plan context, actions that injure plan members, such as an inappropriate denial of plan benefits, may be intentional torts and may be resolved on that basis. The failure to appropriately counsel a retiring plan participant about plan benefits and options and the subsequent choice by the person of a less advantageous benefit or option, if a plan governing board or plan administrator has a duty or assumes the duty to counsel, may be a negligent tort and may subject the governing board member or participant to liability in its resolution.

Similar to the *Restatement of Trusts,* The American Law Institute publishes a compilation of the common law of torts, in the form of the Restatement of Torts, and that document is available for consultation. As in most any common law area, the general common law principles will not be specifically developed for a public pension plan, but will require their derivation from related or similar factual settings.

5. *The Common Law Relating to Contracts.* The final major common law area applicable to public pension plans, plan governing boards and plan administrators is the common law of contracts.

A contract functions as a private law created by an individual process and binding on the parties, with the obligation akin to the legal burden imposed from statutory or related law.

The common law of contracts applies because the relationship between the pension plan and the plan participant may clearly be a formal contract, may be found to be a contract, or may be treated as though it were a contract. In its simplest statement, highlighting the applicable elements, a contract is an agreement between two or more competent parties, with their free commitment to do or to refrain from doing a definite legal act, for adequate lawful consideration, in a form required by law.

Because of the seriousness of the relationship, its analogy to public law, and the potential severity of the remedies in the event of a breach of contract (specific or mandated performance of the contract or charging the breaching party with the net value of the contract), the common law of contracts places considerable emphasis on the quality of free consent in the relationship, the mutuality of its obligations, the lack of undue influence or duress in the process, the adequacy of consideration and the legal form of the agreement. The court applying the common law may attempt to reform the contract or rescind it if notions of fairness demand that over strict enforcement.

The common law of contracts will have greatest application in jurisdictions in which the prevailing legal theory of a public pension plan is that of a contract.

III. The Legal Nature and Structure of Public Pension Plans, Funds and Administrative Systems or Structure

A. Differentiation of Public Pension Plan, Fund and System

1. *In General.* In the public employee pension community, the terms "public pension plan", "public pension fund" and "public pension system" are frequently used loosely and interchangeably. In a situation in which the assets of one public pension plan are held without any commingling with other assets in one public pension fund and the plan and the fund are administered by one administrative agency, the interchangeable use of the terms is not particularly problematic or inappropriate. However, not every public pension arrangement is so constituted and the interchangeable use of these terms ignores the potential legal implications arising from and singularly attributable to each.

2. *Definitions.* The terms "public pension plan", "public pension fund" and "public pension system" can be defined as follows:

   - *A public employee pension plan* is that collection of benefit provisions under which a public employee becomes entitled to an immediate or eventual retirement annuity or benefit, under which a public employee or the employer of the public employee, or both, are obligated to pay specified amounts as contributions, and under which the public employee or the employer, or both, are required to undertake certain reporting and related duties. The public employee pension plan usually is reflected in a single plan document or in a small number of documents. The plan document may be a law or other enactment of a government body. The plan document may also be a portion of a collective bargaining agreement or may be reflected in a contract with a third party vendor, typically a financial institution or benefit administration organization.

   - A *public employee retirement fund* is the accounting and investment vehicle for the deposit of any periodic public employee member deductions or contributions and employer contributions, for the segregation of those monies from other monies of the public employer or sponsoring organization, and for the separate investment of those assets and crediting of any investment income derived from those assets. A public employee retirement fund is necessary if the public employee pension plan is to be funded on an actuarial basis or in any manner beyond a current disbursements (or "pay-as-you-go") basis.

- A *public employee pension system* is the administrative entity that is entrusted with the duties of operating a public employee pension plan and a public employee retirement fund. These include interpreting the pension plan, determining the status of plan members, maintaining plan membership records, collecting the required periodic funding, depositing in and withdrawing appropriate amounts from the retirement fund, investing the retirement fund, providing benefit information counseling to plan members and paying retirement annuities and benefits to plan beneficiaries. The public employee pension system can be comprised of one entity or allocated among several separate entities.

3. *Public or Non-public.* The determination of whether or not a pension plan, fund or system is a public plan, fund or system will have legal implications. State or federal regulation may differentiate between public and private pension plans, funds or systems or may be applicable to only one grouping. For instance, the applicable plan qualification standards of the federal Internal Revenue Code for the special tax-exempt treatment of pension plans differ for "governmental plans" when compared to other types of plans, with governmental plans held to the pre-ERISA qualification standards, and with most other plans held to the full ERISA qualification standards. Legal responsibilities and legal liabilities of the plan, fund, system and administrators also will differentiate between public and non-public pension plans, funds and systems. For example, state regulation of the benefit and related aspects of a pension plan generally is allowed only for "governmental plans" and is superseded or preempted by federal law for non-governmental plans.

   The distinction between public pension plans and non-public pension plans typically will be a function of the character of the plan membership, the source of all or a portion of the pension fund's contributions or revenue, the nature of the plan organizing document or governing plan document, or the character of the sponsoring employing unit or units. Under ERISA, the major federal pension legislation, governmental pension plan status is determined primarily on the basis of the character of the employing unit or units sponsoring the pension plan. State regulation may focus on the nature of the plan membership, based on an explicit or implicit definition of a public employee, may be determined on the basis of the source of all or a portion of the contributions to or revenue received by a pension fund, or may be applicable based on the existence of statutory or ordinance law as the plan document or organizational basis.

4. *Varieties of Public Pension Plans.* There are various types or kinds of public employee pension plans and the particular type or kind can have potential legal implications.

   a. *Insurance Involvement.* One potential measure differentiating public employee pension plans is the presence or absence of insurance with third party carriers for the liability for retirement benefits. Public employee pension plans can be wholly insured, partially insured and partially self-insured, or wholly self-insured. The insurance coverage in this instance is the presence of an enforceable commitment to cover the risk of providing funding to the pension plan in the event of additional unfunded actuarial accrued liabilities, generally resulting from experience losses. For instance, if a public employee pension plan is committed to pay a retirement annuity in a particular amount for the recipients' life and the recipient actually lives to an age well in excess of the generally expected mortality, perhaps to age 100, and there is no corresponding early benefit recipient death or set of early benefit recipient deaths to offset the additional unfunded actuarial accrued liability, the insurance carrier in an insured pension plan would be obligated to provide additional resources to cover the liability.

A wholly insured pension plan is a plan in which all liability for pension benefits under the plan is underwritten by an entity or entities other than the plan or the sponsoring employing unit or units. A partially insured pension plan is a plan in which the liability underwriting is limited to something less than the total actuarial accrued liability or total periodic benefit obligations payable. A self-insured pension plan is a plan in which the liability for pension benefits under the plan is not wholly underwritten by an entity or entities other than the plan sponsor and the risk of experience losses or other additional actuarial accrued liability and periodic benefit obligations payable is required to be borne by the current revenue resources of the plan or by the sponsoring entity or entities. In Pennsylvania, among municipal pension plans, the use of insurance is common. This may reflect the highly decentralized structure of public pensions in that state, the reliance on municipal officials rather than pension administrators to conduct plan operations, and the existence of state aid programs for police officers and firefighters that previously emphasized the use of insurance. In other states, like Minnesota, insured pension plans are rare.

The most immediate legal implication for the pension plan and the plan administrator of the presence or absence of insurance is the extent of the insurance coverage and the pre-conditions for gaining payment from the carrier. Beyond the immediate legal implications are the very particular issues of the enforceability of the insurance coverage by the various parties connected with the pension plan (e.g., sponsoring governmental entity or entities, labor union or unions representing active plan members, or active, deferred or retired plan members) and of the rights of the pension plan, the extent and adequacy of remedies and the timeliness of recovery in the event of a default by the insurance carrier or the liquidation of the insurance carrier.

b. *Defined Contribution or Defined Benefit Plan.* Another differentiation between public employee pension plans is the plan's formulation as a defined contribution plan or a defined benefit plan. The difference, from a legal standpoint, is a function of what is being promised (either a level of ongoing funding or a specific level of benefits) and what benefit amounts, benefit timing and potential beneficiaries can be asserted in any claim against the pension plan.

A pension plan in its broadest sense is made up of two components or potential variables, which are benefits and funding. Since one is derived from the other, they can be characterized on the basis of the component that is fixed and the component that is variable. In a defined contribution plan, the funding of the pension plan is fixed and the ultimate benefit to be provided is variable. The pension plan funding is typically set as a percentage of compensation, although the funding can also be set as a dollar amount, and will entail funding by one or a variety of sources, which are the plan members, the sponsoring governmental entity or entities and related governments (e.g., state pension aid funding provided to a local government pension plan). In a defined benefit plan, the benefit to be provided by the pension plan is fixed or made predeterminable, and the funding required is a variable. Typically in public employee pension plans, the benefits are provided as a percentage of a specified final compensation figure or average and payable in a full (unreduced) amount at a specified age or combination of age and service length. The percentage is typically referred to as the benefit accrual rate. The age for the payment of full benefits is typically referred to as the normal retirement age. Defined benefit plans are more common than defined contribution plans. An example of a defined contribution plan for public employees is the Teachers Insurance and Annuity Association—College Retirement Equity Fund (TIAA-CREF) applicable to higher education faculty in some jurisdictions. Similar defined contribution or "money purchase" pension plan arrangements may also be available to faculty members, as is the case in both Minnesota and Pennsylvania. In recent years, some states utilize both types of plans, as does Wisconsin in providing for a variable annuity plan in addition to its defined benefit plan coverage. Some Minnesota volunteer firefighters relief associations have made the transition from defined benefit plans to defined contribution plans.

The most immediate legal implication for the pension plan, the plan administrator, and the sponsoring employing unit or units from the characterization of the pension plan as a defined contribution plan or a defined benefit plan is the nature of the potential rights that are obtained and enforceable by active, deferred or retired plan members. In a defined contribution plan, the rights obtained and enforceable relate chiefly to the amount and timeliness of the contributions made to the plan. Additionally, they relate to the extent of participation allowed in the investment of plan assets in the form of an individual member account, the handling of administrative expenses, the crediting of accrued investment income, and the manner in which the accumulated individual member account balance is translated into a monthly retirement annuity for life. For example, there are questions about what requirements govern in determining the mortality table to be used in benefit computations, who determines the appropriate table, and what latitude is there to change the mortality table.

In a defined benefit plan, the potential rights obtained and enforceable by active, deferred and retired plan members relate primarily to the amount of the promised level of benefits and the age at which those benefits are first payable and are payable without reduction for early retirement. Beyond this, there may be additional enforceable rights related to the amount and timeliness of the funding to the plan and the manner in which early retirement benefit amounts and optional retirement benefit amounts are calculated. For example, there are questions about what role a member can play in enforcing funding requirements against a tardy employing unit, what latitude a member has in questioning an employing unit or the pension plan in determining qualification for plan membership, or what opportunity a member or participating employing unit has to dispute the selection of a mortality table or other nonstatutory actuarial assumption.

c. *Single Employer or Multiple Employer Plan.* Differentiation between public employee pension plans also can be made on the basis of the number of employing units with employees covered by the pension plan. The difference raises legal implications from the extent of the financial and governance responsibility a participating employing unit has over the pension plan and the extent of an agency relationship between the plan and the participating employing unit.

A single employer public pension plan draws its active membership from one participating employing unit. The plan membership may be coincidental with the employing unit's total employee group or may be restricted to a subgroup of the total employee group of the employing unit, such as police officers, firefighters or other public safety officers. The participating employing unit in a single employer pension plan will have sole responsibility for any non-member contribution portion of the funding requirements of the pension plan, except to the extent of any state pension aid provided in the case of a local pension plan. In a single employer pension plan, the pension plan as a practical matter, tends to be a pure extension of the employing unit's personnel system, irrespective of the formal structure and legal status of the pension plan as an entity. For instance, even if the pension plan has a board of trustees separate from the governing body of the employing unit and has the legal status of a separate entity under state law, if the employing unit will not rehire a former disabilitant who the pension plan has independently determined is capable of being reemployed, the employing unit's determination in a single employer pension plan is likely to be more determinative in practice of the person's future status as a benefit recipient than that of the pension plan governing board. Local pension plans in most states are single employer pension plans. In Pennsylvania, there are approximately 2,500 single employer pension plans.

A multiple employer public pension plan draws its active membership from two or more participating employing units. The plan membership is made up of some or all of the employees of a number of employing units, all covered by the same benefit plan. A participating employing unit in a multiple employer public pension plan will tend to be insulated, either formally or practically, from a variety of financial and legal liability factors. In a multiple employer pension plan, liability to plan members and to third parties tends to be pooled and enforceable against the plan and not readily reducible to any one participating employing unit beyond that employer's periodic funding liability under the plan's design. The pooling of risk can be limited to retired member benefits or can be for total benefit coverage for all members. A multiple employer pension plan typically lacks practical and legal identification with any particular employing unit, and its personnel system and plan administrative determinations and plan actions will largely be outside the context of any employing unit's discretion and judgment. State pension plans in most states tend to be multiple employer pension plans. The Minnesota Public Employees Retirement Association covers approximately 1,500 separate jurisdictions. State pension plans that cover one employer primarily may still be multiple employer pension plans, such as the Pennsylvania State Employees Retirement System in covering New Jersey employees of the Delaware River Toll Bridge Authority in addition to Commonwealth employees.

The government accounting profession draws further distinctions in connection with multiple employer pension plans, identifying agent public employee pension plans and cost sharing public employee pension plans. The distinction between an agent plan and a cost sharing plan looks to the basis for determining employing unit funding requirements, and the distinction has potential legal implications. If the plan has no risk or liability pooling or limits risk or liability pooling to retired lives only, and has separate determination of funding requirements from a separate actuarial valuation for each employing unit, the plan is considered to be an agent public employee pension plan. If the plan pools all risks or liabilities, determines the funding requirements of the plan overall and allocates those funding requirements proportionately, the plan is considered to be a cost sharing public employee pension plan. With agent multiple employer public employee pension plans, the liability for the payment of pension benefits and meeting any annual funding requirements are potentially attributable to particular employing units. With cost sharing multiple employer public employee pension plans, the liability for the payment of pension benefits and meeting any annual funding requirements are only enforceable against the current assets and accruing revenue of the public employee pension plans.

B. Legal Status of Plan, Fund, and System

Public employee pension plans, public employee pension funds and public employee pension systems can vary in their status as separate legal entities. Typically, public employee pension plans, funds and systems are creatures of statutory enactments, either directly by the specification of all or most key elements of a benefit plan in statute, or indirectly by the broad authorization in statute of a benefit plan with applicable limits on or minimums for the key elements of the benefit plan. The statute may directly confer on the pension plan, fund or system the status of a legal person on a par with a corporation, may leave the pension plan's legal status to be derived from the governmental entity, or may combine governmental entity status and corporate status. In Minnesota, for instance, all local public pension plans except one have the legal status of a corporation. The sole exception, the Minneapolis Employees Retirement Fund (MERF) does not have the explicit status of a corporation, remains an instrumentality of the City of Minneapolis and Special School District No. 1, but has the statutory power to sue and be sued.

If the public employee pension plan, fund or system has a separate and distinct legal status, it is because the plan, fund or system is accorded the status of a governmental subdivision or municipal corporation, or is accorded the same status as a business corporation, or is organized as a business corporation or nonprofit corporation, or is simply granted a separate independent legal status without specific reference to an existing legal format.

As a practical matter, this legal status affects the number of parties potentially affected by any litigation and potentially responsible for any imposed liability. If the plan is a separate legal entity, the parties to the litigation will likely be limited to public pension plan officials. If the plan is a particular legal entity, such as a nonprofit corporation, the parties to litigation and potential liability will be determined in the context of that body of developed law. If the plan is not a separate legal entity, the parties to the litigation will likely include the appropriate officials from the applicable governmental unit.

IV. Specific Responsibilities and Liabilities of Public Pension Plan Governing Boards and Administrators

A. Introduction

The governing board members and administrators of public pension plans have numerous specific responsibilities with respect to the public pension plan, its associated public pension fund and its administrative system. Failure to undertake these responsibilities or the inappropriate or negligent exercise of these responsibilities will usually make the person or persons involved in or responsible for the activity liable for the imposition of some sanction or remedy.

These specific responsibilities and the associated liability or liabilities fall into four broad areas, which are pension benefit responsibilities and liabilities, pension plan funding responsibilities and liabilities, plan fund investment responsibilities and liabilities, and pension plan administration responsibilities and liabilities other than investment.

B. Pension Benefit Responsibilities

1. *In General.* Pensions are an evolving area in both the governmental sector and the private sector. Pension plans are part of the personnel system and are part of the employment compensation and benefits program. As such, pension plans should assist and augment other parts of the personnel system by aiding in the recruitment of new qualified employees, by assisting in the retention of existing productive and talented employees, and by allowing for the regular and systematic out-transitioning of retirement-eligible employees at the end of their regular work career with the employer and of disabled employees at the end of their productive duties for the employer. In the private sector, pension plans additionally may be established for employer income taxation deferral purposes, since a portion of the profits of the enterprise may be contributed to a pension plan and the employer will receive a federal income tax deduction for those contributions. Although tax deductibility of employer contributions is not a factor for governmental employers, the establishment of pension plans in the public sector additionally may occur for a public welfare purpose in order to reduce or eliminate the possibility that retired governmental employees would be required to go on public assistance during their retirement.

   Pension plans accomplish the various purposes for which they were created by providing pension benefits. The chief responsibility of the governing board of the public pension plan and of the public pension plan administrator is the payment of those benefits solely to qualified individuals, in the correct amount, and in a timely fashion. The areas of responsibility with respect to pension benefits are:

1. the setting of pension benefit levels;
2. the determination of qualified pension benefit recipients;
3. the determination of specific pension benefit amounts; and
4. the timeliness of pension benefit payment.

2. *Establishment of Pension Benefit Levels.* In many public pension plans, the authority to establish the level of pension benefits resides with the state legislature, the governing body or bodies of the affected governmental subdivision or subdivisions, or both. However, the establishment of pension benefit levels may be delegated or accorded in some part to the pension plan governing body or plan administrator. In some cases, such as disability benefits, the plan governing body may be charged with setting the particular level of benefits within a statutory or other prescribed range. In other cases, typically where the benefit plan aspect is funded from investment or other actuarial gains, the plan governing body or administrator may have the authority to set the amount of post retirement adjustments, supplemental benefit amounts or other pension benefit amounts. Also, the plan governing body or plan administrator may have the authority to establish actuarial assumptions where the assumptions directly affect benefit amounts (such as interest rate assumptions or mortality assumptions for defined contribution plans or defined benefit plan optional annuity forms) or the authority to establish optional annuity forms (such as joint and survivor optional annuities, term certain optional annuities, or partial lump sum and partial monthly annuity payment options), either on an actuarial equivalent basis or on some other prescribed basis.

In establishing pension benefit levels, there are several aspects of the responsibilities of plan governing boards and administrators that need to be identified and analyzed. In a defined benefit plan, the authority to establish pension benefit levels is the exercise of the ultimate discretion with respect to the pension plan and, by virtue of the exercise of that discretion, raises fiduciary responsibility considerations. The notion of fiduciary responsibility was discussed briefly in the discussion of the common law on trusts as a source of legal obligations for plan governing boards and administrators. As indicated there, fiduciary responsibility as a principle was developed in the context of a situation most closely analogous to a defined contribution pension plan and historically has been viewed wholly or principally as a pension fund investment issue. Although typically relegated to pension fund investment matters, fiduciary responsibility has application to the pension benefit level establishment process because of the degree of discretion that may be accorded to that area in a defined benefit pension plan and the degree of loyalty that may be reasonably expected of plan governing boards or administrators by current or potential plan beneficiaries. In applying fiduciary principles derived from the federal Employee Retirement Income Security Act (ERISA) and similar pension plan fiduciary regulations, pension benefit levels should be established:

1. solely in the interest of the plan participants and beneficiaries;
2. as an exercise of the exclusive purpose of providing benefits to participants and beneficiaries and of defraying reasonable plan administration expenses;
3. with that degree of care, skill, prudence and diligence under the prevailing circumstances that a prudent person (or expert) acting in

a similar capacity and familiar with the subject would use; and

4. in a manner consistent with the plan's governing law and documents.

Compliance with the first two of these fiduciary responsibility regulation based requirements should generally provide no great difficulty, especially if the establishment of pension benefit levels results in greater benefits or improved benefits. If establishing a pension benefit level results in lower benefits, such as the impact of a blended unisex mortality table for some plan members, the exercise of discretion becomes more difficult. Compliance with the third fiduciary requirement also may be more problematic, since the criteria for judging conduct is applied after the fact and is inherently based on hindsight or conjecture. Prudence may require incremental changes rather than sweeping changes. If the benefit establishment component occurs in the face of a changing environment, such as establishing a mortality table in the face of a changing pattern of retirees in choosing optional annuity forms, the extent of vision needed to meet the requirement of prudence may be difficult to judge in advance and difficult to defend in retrospect. Consistency with the applicable governing law is attainable. While legislative enactments frequently have ambiguities (unintended or intended), the broad thrust of legislation generally can be discerned and the resolution of derivative questions in a manner consistent with the broad thrust is generally possible. If a legislative enactment is very unclear in its broad thrust as well as its specific requirements, the ambiguities should be reconciled through consultation with the pension plan counsel (and state's attorney general, if applicable) and by comparison to prior administrative practice in any related area within that pension plan or by comparison to similar legislation and resulting administrative practice in other pension plans, or if not possible administratively, through a legal action for a declaratory judgment on the intent of the law.

In the actual exercise of any permitted discretion in establishing pension benefit levels, the plan governing board and administrators must be conscious of equal protection concerns arising out of federal and state constitutional law. Unless there is a need to make distinctions, and a rational basis exists for the classifications on which those distinctions are to be made, the principle of equal protection of the laws requires similar treatment of similar circumstances. If the distinctions are based on certain protected class attributes, such as race, religion, national origin, or sex, the rational basis for the classification will be subjected to considerable scrutiny by the courts upon any challenge. Thus, if the public pension plan governing board or administrators have the power in whole or in part to specify inclusion in or exclusion from the pension plan membership, caution should be exercised. For example, exclusions of resident aliens from the pension plan membership are unlikely to be upheld and should be avoided. Similarly, any restrictions imposed on the payment of pension benefits outside the United States may be violative of equal protection, although a narrow requirement that non-United States pension payments be made through direct deposit in a banking institution subject to federal banking regulation is more likely to be upheld on the basis of protecting procedures for recovery of overpayments or on the basis of protecting against fraud.

3. *Modification of Existing Pension Benefit Levels.* Although the topic merits a longer discussion than is possible in this document, the discretion to establish pension benefit levels raises the question of the authority to modify

any public pension plan benefit or related provision in a manner potentially adverse to one or more current plan members.

While this question usually arises in connection with the power of legislative bodies to alter public pension plans, the discretion allowed in some jurisdictions to pension plan governing boards and plan administrators to establish pension benefit levels or implement related regulations may be subject to a challenge based on a potential or actual diminishment. Examples of situations in which a potential or actual diminishment in pension benefit coverage would occur include the revisions of interest rate or mortality actuarial assumptions that would affect defined contribution benefit amounts when experience demands it, the revision in the minimum length of service to obtain full service credit when the minimum school or other employment year is lengthened, or an increase in the member contribution rate when other benefits are increased or the actuarial cost of the plan changes substantially due to recent experience, changed assumptions or changed membership. The diminishment in benefits may be done as a trade-off in connection with other benefit or similar improvements (e.g., drop in benefit accrual rate to account for increase in covered salary or imposition of service credit maximum in connection with benefit accrual rate increase), or the diminishment may be unrelated to any other benefit or related change (e.g., imposition of post-disablement medical exams and benefit suspensions following the actual or perceived practice of lax disability determinations or exclusion of various forms of severance pay from average salary determinations in light of actual or potential final salary padding).

For some public pension plans, such as those in Illinois or New York, some or all benefit diminutions are impermissible under the state constitution, depending on how diminution may be defined by the court. For other public pension plans, such as those that are collectively bargained, the changes implementing actual or potential diminutions are permissible only at the end of the term of the contract and as part of the negotiations process, unless the pension plan can convince the court of the need for reformation or recision of the contract or unless bankruptcy is involved. In other states, actual or potential diminutions have been held impermissible based on a developing common law on public pensions. In overturning laws diminishing pension benefits, the Minnesota court has considered the theory of unilateral contract and the theory of promissory estoppel giving rise to a quasi-contract. In Pennsylvania, the court has generally disallowed any change in any benefit plan provision that independently would produce a benefit diminishment, using a generalized contract theory of public pensions, with the chief potential exception limited to actuarial or fiscal necessity. The courts in a diminishing number of states do not use some form of a public pension contract theory and instead rely on the older gratuity theory, which generally allows any modifications because the pension benefit is viewed as a gratuity that is open to unilateral change. The public pension plan governing board or plan administrator should attempt to discern the approach used in that jurisdiction, if ascertainable. If the approach is unclear in general or is unclear with respect to the particular potential change, the board or administrator should proceed following the fiduciary principles similar to those outlined in this section and should implement the diminishment only if there are clear and compelling reasons for doing so, no alternative approach can resolve the problem, the diminishment is as narrow as possible, and the diminishment does not violate the board member or administrator's sense of fundamental fairness.

4. *Procedural Due Process Considerations in Eligibility, Participation and Benefit Entitlement.* In the administration of a pension benefit plan, a pension plan governing board or plan administrator must make factual determinations that have a bearing on the amount, timing, and duration of and on the eligible payee for pension benefits. In making these factual determinations and in applying the conditions and prerequisites of the benefit plan, there are procedural due process considerations that must or should be taken into account.

   Under federal and state constitutional law notions of due process, property or a property right cannot be adversely impacted or taken by a governmental entity without observing procedural considerations. Public pension benefit coverage and entitlement will generally be considered to be property bringing due process protections. To conform with due process safeguards, public pension plan governing boards or administrators should follow any notice and review procedure provided for in the benefit plan document, if it meets minimum due process requirements, or should establish a due process notice and review procedure if the benefit plan document lacks a procedure or the prescribed procedure does not meet minimum due process requirements. The need for a due process hearing procedure arises when a benefit is terminated, suspended, adjusted downward in amount, or when there has been an adverse determination regarding eligibility, status or credit affecting a plan member, potential plan member or beneficiary.

   The elements of a notice and review procedure that likely will meet any minimum due process scrutiny by the court are:

   a. *Notice:* The plan must give notice to the affected person of the adverse determination or action, transmitted to the person in a manner that is reasonably calculated to be received by the person, with personal transmittal of the notice if necessary. The notice should be in writing and should clearly specify the adverse determination or action and its factual and statutory basis.

   b. *Appeal or Review Opportunity:* The plan must provide the person adversely affected by a plan determination or action with the opportunity to petition for an appeal or review of the adverse determination or action. The appeal or review petition should be required to be in writing, but should have few formal content requirements.

   c. *Answer:* The plan should provide a written answer to the appeal or review petition, indicating in appropriate detail the reason for the adverse determination or action and specifying the time, date and place of the hearing and any other pertinent information about the form and nature of the hearing.

   d. *Open Accessible Record:* The plan should provide the aggrieved person with an opportunity to add any pertinent information or commentary to the record of the person to be used in the appeal or review and to review the record on which the adverse determination or action is based.

   e. *Hearing:* The plan should conduct a hearing on the appeal or review petition, with the aggrieved party having an opportunity to be present, to have appropriate legal or other counsel present, to present the basis for the person's appeal or review and the rationale for a different result, and to confront adverse witnesses or contradict adverse information. The appeal or review hearing should be conducted by a person or body not directly involved in making the initial adverse determination or ordering the initial adverse action. If the plan administrator has the authority to make the initial determinations or order the initial action on plan benefits for the plan, the pension plan governing board can function as the appeal or review hearing body. If all determinations or actions are done directly by or on behalf of the governing board, then a separate person or body must be utilized to conduct the hearing and resolution of the review or appeal petition. Notification of the final action should be made in writing to the petitioner.

f. *Judicial Review:* The plan should provide for judicial review of all final administrative decisions after the conclusion of the appeal or review process, consistent with local civil procedure requirements.

The procedure outlined above may exceed minimum constitutional due process requirements for some jurisdictions. The procedure described above, however, if implemented, should be largely free from constitutional attack if undertaken in good faith.

The due process appeals or review procedure should be applicable to situations such as denial of benefit applications, denials of plan membership or benefit eligibility, terminations of benefits for eligibility loss (e.g., recovery from disability or remarriage by surviving spouse) or receipt precondition violations (e.g., failure to return benefit receipt confirmation forms or applicable outside income receipt documentation), or reductions in benefits based on subsequent events (e.g., income by retiree in excess of reemployed annuitant earnings limitations or receipt for the designated period for an accelerated amount annuity such as pre-Social Security benefit recipient accelerated annuity options).

C. Pension Funding Responsibilities

1. *In General.* In order to actually provide pension benefits to potential recipients, public pension plans must be funded. If the pension plan is a defined contribution plan, the benefit is a function primarily of the aggregate periodic funding of the plan (employee contributions, employer contributions or both). If the pension plan is a defined benefit plan, the benefit is generally a function of a mathematical formula that is unrelated to the level of pension funding, and the funding of the plan must be determined separately and functions largely as a budgeting tool for the plan sponsor or sponsors.

In funding a defined benefit plan, numerous funding strategies can be employed, ranging from non-actuarial current disbursements ("pay-as-you-go") funding to actuarial funding. Unless the pension plan is willing to risk benefit defaults and no party will be required to immediately remedy any default, pension plan funding represents implicit or explicit decisions about the extent of benefit security to be provided to plan members and beneficiaries, the timing of benefit funding, the sources of benefit funding, and the relative burden of funding between the various sources. With current disbursements ("pay-as-you-go") funding, no appreciable amount of assets is ever accumulated relative to accrued pension liabilities, no significant benefit security is ever extended to plan members and beneficiaries, the bulk of funding is shifted to a future time when the plan membership is likely to be more mature (greater number of retirees as compared to active members), investment income is essentially eliminated as a source of a portion of plan funding, and employer contributions will bear the most substantial burden of pension funding. Historically, Social Security has been an example of the current disbursements funding approach. Actuarial funding will increase benefit security for plan participants and beneficiaries, a significant portion of the funding requirement will be recognized and paid during the working lifetime of plan participants, investment income will fund a significant portion of pension benefit outlays and the burden of funding on employer contributions will be reduced significantly.

The choice between pension plan funding alternatives for public pension plans will be made either by the plan sponsor in establishing the plan or by legislation in regulating the plan. The choice generally is not made by the pension plan governing board or plan administrator. Thus, the responsibility of the governing board or plan administrator is usually to implement the established funding procedures.

2. *Determination of Funding Requirements.* In a defined contribution pension plan, as the name indicates, the amount of contributions is specified in some manner and the funding requirements of the pension plan will be determined accordingly. Generally, the funding requirement will be specified as a percentage of covered salary, although the requirement could be set as a dollar amount. The responsibility of the plan governing board or plan administrator in determining the funding requirement will be limited to ascertaining the correct salary amount of each participant and assessing the correct contribution amount based on the specified percentage to the employer, employee or both.

   In a defined benefit plan, the determination of funding requirements is more complicated. Funding requirements can be based on the results of periodic actuarial work or can be based on a specified contribution rate or percentage set independently of the periodic actuarial work. If the funding requirements are set as a percentage of payroll or set as a particular rate without any direct automatic tie to periodic actuarial work, the responsibility of the plan governing board or administrator will be the same as with a defined contribution plan. If the funding requirements are a function of the periodic actuarial work, the responsibility of the plan governing board or administrator will be substantial, with a duty to have the periodic actuarial work performed on a timely basis, to have the periodic actuarial work prepared according to all applicable standards or requirements, and to translate the actuarial work into a contribution rate or amount. If the funding requirements must be translated into proposed appropriation legislation, the plan governing board or administrator will have responsibility to submit the appropriate legislation.

   For a pension plan that is funded on the basis of periodic actuarial work, the actuarial work can be prepared wholly or substantially under statutory requirements or can be prepared primarily at the discretion of the plan governing board or the plan administrator. If there is discretion in the preparation of periodic actuarial work, that discretion will generate a corresponding legal responsibility and possible liability for the plan governing board or plan administrator. In addition to the broad fiduciary responsibility criteria outlined in the administration of pension benefit section (emphasizing operation with sole plan participant interest, exclusive purposes of providing benefits and defraying reasonable administrative expenses, prudence and consistency with plan law and plan documents), the plan governing board or administrator's obligation as a public official also comes into play. As public officials, plan governing board members or administrators have an obligation to the governmental unit or units served by the pension plan and the taxpayers supporting the governmental entity or entities and the plan. A clear understanding of the reason for funding public pension plans can allow for a reconciliation of the plan official's fiduciary obligation with the plan official's obligation as a public official. While any actuarial funding method and accompanying actuarial assumptions and techniques, if actually implemented, will result in the funding of a public pension plan, the chief consequences of different funding patterns are those of the timing of meeting financial requirements, the relative security of pension obligations, and the source of funding support. Both plan participants and the sponsoring governmental entities are best served by a full disclosure of pension liabilities and funding requirements, by consistency in results from year to year, and by stability of results over time. Hence, the reported situation of some New York City pension plans in the 1960's and early 1970's involving the use of a 50-year-old mortality table without any substantial upgrading did not, in the long term, function to the advantage of either the plan participants and beneficiaries or the governmental unit, since the failure to produce realistic actuarial work diminished plan participant and beneficiary benefit security while also providing only a temporary reprieve from appropriate contribution levels for the governmental units. While New York City contribution levels were artificially restrained in that situation for a period of time, the eventual recognized actuarial liability of the plan and the eventual employer obligation increased substantially, leading eventually to a dramatic rise in employer contributions, and shifting a funding burden in part from potential investment earnings to actual employer contributions.

Attempting to produce fully disclosed, consistent and stable actuarial valuation results presents some difficulties for plan governing boards and plan administrators to overcome. A chief potential problem is the growing impact of accounting rules on pension plan actuarial work and funding levels. Increasingly, the annual financial reporting by the pension plan and by the governmental unit under generally accepted accounting principles (GAAP, either the Financial Accounting Standards Board (FAS or FASB) Statement 35 or the Governmental Accounting Standards Board (GASB) Statement 5) impacts potential funding decisions. The accounting rules do this by calculating the overall pension liability and recurring pension cost in a manner that is likely to be different from the actuarial method historically or typically used for funding public employee pension plans. The actuarial methods specified by the accounting rules are based on the projected unit credit actuarial method, which typically reflects less liability and less current cost than the actuarial methods that are historically and generally used by public pension plans, such as the entry age normal actuarial method. Plan governing boards and plan administrators may be faced with the problem of preparing accounting materials that disclose a smaller overall pension liability than they are certifying under the periodic actuarial valuation. Employers with budgetary concerns are likely to seize upon the more modest pension liability results. Pension plans in Texas are reported to have shifted recently to the projected unit credit actuarial method over the objections of the plan governing boards. The Minnesota

Department of Finance recently has explored the same proposal for some of the Minnesota public pension plans.

3. *Benefit Increase Cost Estimates.* As part of the process of approving increases or modifications in benefit amounts or levels, good policy-making requires the preparation of a cost estimate of the actuarial impact of the benefit change. To the extent that the public pension plan has the power to approve the benefit modification, or has the authority to seek or request the enactment of the benefit modification, or is responsible for the preparation of periodic actuarial valuations for the plan for which a benefit modification is proposed, the plan governing board or plan administrator should undertake all actions necessary to have an actuarial cost estimate of the benefit modification prepared, if feasible.

   The obligation to provide benefit increase cost estimates is related to plan funding, because pension plan benefits cannot be separated from pension plan funding and because the actuarial cost estimate will or may become the basis for setting the funding requirements and contribution amounts for the period following the implementation of the benefit modification.

   The obligation to request, or prepare, or obtain actuarial cost estimates of benefit modifications arises out of both the fiduciary responsibility obligation of the plan governing board or plan administrator and the general obligation of a plan governing board member of plan administrator as a public official. Fiduciary responsibility components such as the obligation to engage in conduct as a prudent person and the obligation to exercise authority for the exclusive purpose of providing benefits and reasonable administrative expenses give rise to this actuarial cost estimate requirement. The whole process of appropriate benefit increase requests, drafting and enactment requires an understanding of the actuarial cost implications of the benefit modification and prudence and care and the exclusive purpose of providing benefits require the matching of financial resources with benefit outlays.

4. *Plan Disbursements.* A pension plan governing board member or plan administrator has a fiduciary obligation to operate the pension plan and pension fund for the exclusive purposes of providing retirement benefits and paying reasonable and necessary plan administrative expenses.

   If the pension fund utilizes a formal trust, the pension fund will have a trust instrument and that trust instrument will delineate the purposes for which fund assets may be expended. Similarly, the legal enactment or enactments establishing or governing the pension plan may restrict the purposes for which pension fund disbursements may be made.

   Pension benefit payments usually are less problematic than pension plan administrative expenses, because the plan governing enactment or document usually will be quite specific in setting forth both benefit amounts and benefit timing. Pension benefit payments, of course, must be made only to eligible recipients in the correct amount and at the correct time. To meet its fiduciary obligation, a pension plan governing board or plan administrator should establish clear internal procedures, with appropriate checks and reviews, for establishing eligibility of potential benefit recipients, for determining benefit amounts, and for processing benefit payments on a timely basis. In establishing the eligibility of potential benefit recipients, there should be the appropriate checks for age, service credit for vesting purposes, disablement for disability benefit coverage, and survivorship for death benefit coverage. In determining benefit amounts, the internal procedures should verify the final salary, final average salary or other salary base, age, and service for benefit accrual, along with applicable verified information related to any optional annuity form selected. For processing benefit payments in a timely fashion, the appropriate addresses, automatic bank deposit forms, or other related information must be secured.

Pension plan administrative expenses, although likely to be in an amount substantially less than total pension benefit payments and hence less important monetarily, are more problematic because of the range of possible expenses and the likelihood of a general lack of specificity in the plan governing law or document in indicating authorized administrative expenses. First and foremost, administrative expenses must be necessary and reasonable. The requirement that administrative expenses be necessary is generally understood to mean that the expenses are directly related to the function of the pension plan, such as salaries of administrative staff, consulting and professional services such as actuarial services, auditing services, investment services and medical evaluation services, and general operating expenses such as postage, printing, office equipment and office supplies. The requirement that administrative expenses be reasonable is usually understood to mean that the expenses do not exceed the customary marketplace price range for that type, quantity and quality of services. Reasonableness frequently may be determined by competitive bid or by comparative requests for proposals. The plan administrator or plan governing board should establish the required internal policies and controls for purchasing, contracting for professional services, salaries and fringe benefit levels, and travel reimbursement. These policies and controls should comply with any applicable or required fiscal policies and controls established generally for the governmental unit.

5. *Funding Related Obligations of Other Associated Parties.* While pension plan governing board members and plan administrators have the primary responsibilities with respect to the funding of a public employee pension plan, other parties connected with the public pension plan may also have legal responsibilities for certain duties that are part of the public pension plan funding process.

In a single employer public pension plan, the governmental employing unit generally provides a significant portion of the plan's funding and generally handles member contribution amounts through a payroll deduction process. In states where there exist programs of governmental aid that are dedicated for pension purposes, the governmental subdivision will frequently be the recipient of the pension aid and must ensure that the pension aid amount is appropriately used for its dedicated pension purpose or purposes. The applicable governmental subdivision officials in these instances are likely to be found by a court to have a trust relationship with respect to the pension plan and hence will be held by the court to a fiduciary obligation towards the pension plan with respect to the funding. This will require the correct deduction of member contributions, the correct calculation of any periodic, recurring, or lump sum governmental unit contributions, the appropriate disbursement or forwarding of any governmental pension aid amounts and the timely transmittal of any other pension revenue amounts due.

Governmental employing units also play a significant role in the funding of multiple employer public pension plans and have many or all of the same responsibilities as governmental units with single employer public pension plans. As indicated earlier, multiple employer pension plans may assume only an agency role, in which each governmental unit bears ultimate responsibility for its distinct pension liability, or may assume a cost sharing role, in which all governmental units share a joint undivided responsibility for the total pension plan liability. The agency role or the cost sharing role each may have implications for the officials of the respective government units, since the cost sharing role may be viewed as carrying with it an obligation towards the other participating units akin to a fiduciary responsibility. The discretion and latitude accorded each governmental unit in a cost sharing public pension plan to create a joint liability through its individual actions creates a duty with each governmental unit to exercise its discretion and latitude with prudence, care and a sense of loyalty towards all other governmental units. For example, if one governmental unit in a cost sharing multiple employer pension plan undertakes a pattern of understating the reported covered compensation of plan members until the immediate pre-retirement period (by omitting compensation items such as annual bonus payments, uniform or clothing allowances, shift differentials, etc.), other governmental units may conclude that this practice inappropriately shifts a portion of the burden of the funding of the plan to them and may successfully litigate a discontinuation of the practice and the payment by the offending governmental unit of the previous employer contribution burden inappropriately shifted.

D. Pension Fund Investment

1. *In General.* The area of pension fund investment is the area of the greatest development of specific responsibilities of plan administrators and plan governing boards. Much of this developed body of responsibilities is in the area of fiduciary responsibility, although additional investment related public pension plan regulations or obligations have emerged.

   As trust law and pension plans have grown during their early stages, the chief administrative area of concentration is that of investment. Asset investment was the area of greatest value in both non-pension trusts and pension funds. It is also the area of greatest risk to plan participants, plan sponsors, or both, in the event of mismanagement, neglect, negligence, fraud, theft or embezzlement.

2. *Investment Related Fiduciary Responsibility Regulations.*

   a. *Imposition of Fiduciary Responsibility Regulation.* Over time, there has been growing recognition of the special relationship that exists between individuals covered by a pension plan, whether private sector or public sector, and the individuals operating or administering that pension plan. With the establishment of trusts in connection with pension funds associated with pension plans and the similarity to the fiduciary relationship that exists in private trusts, fiduciary responsibility and liability principles have increasingly been applied to pension plan operation and administration. Initially, this extension occurred on a voluntary basis by action of the pension plan or by common law development. Increasingly, the extension of fiduciary responsibility and liability principles has occurred by virtue of statutory enactments. In the private pension plan area, the Employee Retirement Income Security Act of 1974 (ERISA) accomplished this extension. In the public pension plan area, the extension occurs by individual state law action. In Minnesota, the extension occurred in 1989 with the passage of Minnesota Statutes, Chapter 356A. In Pennsylvania, the extension occurred in the early 1980's with the addition of cross-references to the state's fiduciary code to the various municipal pension plan laws. Many other states have laws that contain similar provisions.

b. *Function of Fiduciary Responsibility Regulation.* Inherent in pension plan fiduciary responsibility and liability, as in any regulation, are the benefits of its dual functions as a guide and as legal recourse. In its function to provide guidance, pension plan fiduciary responsibility and liability regulation assists individuals who have a role in the operation of a pension plan by indicating to them the manner in which they are to perform those duties. In its function to provide legal recourse, pension plan fiduciary responsibility and liability regulation assists pension plan participants and benefit recipients who are injured by the failure of public pension plan operatives to responsibly perform the duties of their positions by allowing them to recover damages suffered from that failure or to pursue other relevant remedies. In providing guidance and legal recourse, well developed fiduciary responsibility and liability regulation serves as both future oriented and retrospective regulation. The regulation as guidance is future oriented and provides sufficient notice to affected individuals of their status, the standard by which their conduct will be judged and the liability that may be imposed in the event of a breach. As future oriented regulation, well developed fiduciary responsibility and liability regulation is the best form of broad regulation by clarifying the standards and thereby preventing substandard performance.

The regulation as legal recourse is essentially retrospective and provides a means by which persons connected with a public pension plan who believe that they have been damaged by substandard performance by the public pension management may have that dispute resolved and may be awarded relief by the court if their belief is well founded. As retrospective regulation, well developed fiduciary responsibility and liability regulation allows injured individuals to recover their losses resulting from a prior misdeed with respect to the public pension plan. The actual imposition of damages needed to allow individuals to recover related losses may function as a deterrent for other public pension plan management personnel and may thus add a preventive function to earlier retrospective regulation.

c. *Development of the Fiduciary Concept.* Inclusion in the definition of pension plan fiduciary status will cause a person to be covered by the various aspects of the regulation of fiduciary affairs and will subject the person to potential liability in the event of a breach of the person's fiduciary duty. As the concept has developed in Roman law and has been incorporated into Anglo-American law, a fiduciary can be defined as a person who has legal responsibility for the conservation and management of property in which another person has a beneficial interest. The broad definition, however, is not particularly useful in the current circumstances in determining those persons connected with the relatively unique property interest represented by a pension plan will specifically be deemed to be fiduciaries and consequently be held potentially liable in the event of a breach.

Historically, the primary aspect or characteristic that differentiates between pension plan fiduciaries and individuals performing purely ministerial duties in connection with a pension plan is the question of the presence or absence of discretion. If an individual has discretion with respect to the actions performed in connection with a pension plan, the theory is that the individual has critical choices that reflect both a policy orientation and personal integrity, and should be held liable for unreasonable mistakes in judgment or losses resulting from those choices.

d. *Prohibitions from Fiduciary Positions.* In some instances, for basic public policy reasons, it is necessary to prohibit some persons from undertaking functions with respect to a pension plan that potentially or actually involve a fiduciary capacity. The prohibition would function as preventive regulation by banning those persons from various significant or discretionary pension plan employment positions, consultant positions or activities because of their previous proven criminal activities that arguably involve moral turpitude. To avoid potential federal constitutional due process or equal protection problems, these prohibitions are generally triggered by final conviction of a specified crime and continue for only a specified period of time. These prohibitions typically are accompanied by a penalty in the event of a violation.

e. *Activities Subject to Fiduciary Regulation.* The area of pension plan activities traditionally subject to fiduciary concern has been the investment of pension plan assets. This is undoubtedly a reflection of the need for increasing professionalism and accountability present in every investment decision that results from the rapid growth of pension plan assets, the increasing attraction that those assets hold for inappropriate or improper behavior, and the potential threat misdeeds hold for the security of pension benefits, the solvency of the pension plan, and the fiscal stability of those who participate in its financing. However, with the growth of defined benefit plans and the shift in value for plan participants from asset accumulations to a benefit entitlement, non-investment pension plan activities are increasingly becoming subject to fiduciary concern.

f. *Fiduciary Standard of Care.* A major element in fiduciary responsibility regulation is the general standard of care, or measure of conduct, for fiduciary activities. This element deals with the broad obligation that a fiduciary undertakes and how the actions of that person to discharge that obligation will be judged in the event that a legal question is raised. Three different historically utilized general standards of fiduciary care or fiduciary conduct can be identified. These different general fiduciary standards are:

(1) the per se sound or unsound practice standard;
(2) the prudent person rule; and
(3) the prudent expert rule.

The per se sound or unsound practice standard is perhaps the oldest fiduciary standard, and like many of the other standards applicable to this activity area, developed in a setting other than a pension plan setting. This standard was the applicable standard for private trusts before 1830. It was developed as a common law principle in England, and by implication through Anglo-American common law, was the governing fiduciary standard in colonial and early post-colonial America. The basic principle underlying the per se sound or unsound practice standard is that specific investments were deemed to be on their face either sound or unsound for purchase as investments by a trust fund. The purchase of a per se unsound investment security under the standard would be deemed to be a willful default or breach on the part of the trustee or fiduciary and any loss from that per se unsound investment security would be a loss for which the trustee or fiduciary could be held liable. An investment would be per se sound if it involved "public funds", which in the early nineteenth century meant that there was the engagement of the government to pay off the capital of the enterprise, and an investment would be per se unsound if it did not involve "public funds". The per se sound or unsound practice standard has application only to investments and has no potential application to any other fiduciary activity. The standard provides a test of whether or not a fiduciary action would be subject to potential liability based on a single component, with the imposition of liability dependent solely on the result of the fiduciary activity and whether or not a loss was incurred. The standard was an outgrowth of the economic circumstances of the times. It was a time before the explosion of business corporations, when there were few entities engaged in business beyond sole proprietorships and partnerships. It was a time when those incorporated entities that did exist, but were not government supported, were generally engaged in very uncertain or speculative ventures. It was a time when there was very little organized extension of credit to or participation in equity ownership of business organizations beyond the actual operators of the business. While the standard seems dated, it has had some application in current or recent fiduciary responsibility or liability regulation. In some states, public pension fiduciaries were allowed to invest only in one specified type of investment security or in a small number, or legal list, of specified types of investment security. In the event of a challenge to a fiduciary investment action by the public pension plan management under that legal structure, the applicable standard would undoubtedly be the per se sound or unsound practice standard or a narrow variation of it.

The prudent person rule has been the basic rule governing the investment of private trusts in this country since it was announced in the decision of *Harvard* v. *Amory,* 9 Pickering (26 Mass.) 446 (1830). The prudent person rule has frequently been codified into state statutes as the standard applicable to both private trusts and public pension plans. The prudent person rule represented a shift from the per se sound or unsound practice standard to an alternative standard. It assembled and organized a large body of exceptions that had grown up in English case law with respect to that earlier fiduciary standard. In the specific factual situation of *Harvard* v. *Amory,* despite the depreciation occurring in the stocks of two manufacturing companies that did not involve public funds (lacked government guarantees), the Massachusetts court decided that no liability would be imposed on the trustee because of the investment. The court announced its formulation of the prudent person rule, which holds:

> 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.

The prudent person rule is a flexible standard for judging conduct, similar to the negligence standard used by the courts in tort situations. The position of being a trustee places on the trustee a fiduciary duty of loyalty to the beneficiaries of the trust. The measure for the performance of that duty of loyalty is the prudent person rule. Several elements can be identified in the prudent person rule, which are:

(1) that the rule establishes a standard of care by which investment decisions will be judged;

(2) that the rule requires that the standard is to be applied to the specific factual situation as it was understood by the trustee at the time of the making of the critical investment decision or decisions, and not through hindsight;

(3) that the rule compares the actions of the trustee with those of a hypothetical universal rational investor;

(4) that the rule requires knowledgeable and cautious investment, using the methods and techniques for investment that were commonly understood when the investment was made;

(5) that the rule emphasizes a long-term investment perspective and does not permit speculation; and

(6) that the rule emphasizes the joint aims of protecting the principal of the investment and maximizing the income derived from the investment, thus requiring a balancing of two potentially contradictory items.

As the rule has been interpreted by courts over time, it does not require that investments under the rule be those that would be universally agreeable to all persons involved in investment. The rule in application has also allowed for innovation in methods and techniques so long as there is a balance between experience and enterprise. In practice, the courts also tend to emphasize the preservation of principal over the generation of investment income in resolving those actual or potential contradictory goals. The main measure of risk in investment used by the court has been the foreseeable possibility of capital loss. The courts also tend to focus on each individual investment separately rather than on the individual investment in the context of the entire portfolio in applying the standard.

The prudent person rule reflects in large measure the changes in economic life over the last two centuries. It especially reflects the shift from an agricultural economy based on family farm units made up of natural persons to an industrial economy based on a large number of corporations, characterized as legal persons rather than natural persons, and the shift to a substantial market society with large accumulations of capital and extensions of credit.

The prudent expert rule is a recent federal statutory modification of the traditional prudent person rule. The federal enactment involved is the Employee Retirement Income Security Act of 1974 (ERISA), specifically section 404(a)(1). The prudent expert rule is similar to the prudent person rule in its flexible comparative approach and in many of its specific provisions. The key difference between the prudent expert rule and the prudent person rule is the basis for the comparison. The prudent person rule drew a comparison of the actions of a particular fiduciary with those actions that would have been undertaken by a hypothetical universal rational investor managing the investor's own affairs. The prudent expert rule draws a comparison of the actions of a particular fiduciary with those that would have been taken by others acting in a like capacity in conducting an enterprise of a like character and with like aims. The comparison is, in other words, with an investment expert. The rule thereby gains strength as a standard for evaluating past actions from the level of skill inherently included in the measure, but is also subject to the biases and limitations of perspective that reliance on an expert perspective bring. The ERISA prudent expert rule requires that the pension plan fiduciary discharge the duties of that position

> . . .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 . . .

Missing from the ERISA prudent expert rule are the provisions of the older prudent person rule that disallow speculation and that emphasize the joint goals of the maximization of investment return and the maximization of investment capital safety. The ERISA prudent expert rule also is viewed by many commentators as shifting the focus of the comparative standard of care away from a consideration of specific investment securities individually, as occurred with courts applying the prior prudent person rule. The focus under the ERISA prudent expert rule has been shifted to that of the entire investment portfolio and to total portfolio objectives. The prudent expert rule is undoubtedly a reflection of the growth of professional investment management that did not exist in 1830, when the prudent person rule was formulated, and represents an adaptation of the prior prudent person rule to presumably better govern that professional management and better accommodate its actual practices and approaches.

g. *Additional Specific Fiduciary Duties.* There are a number of specific fiduciary duties, in addition to the general fiduciary standard of care governing the investment process, that have been imposed in some jurisdictions on pension plan fiduciaries historically. Some have their basis in statutory enactments, while others have been derived as part of the common law. These additional fiduciary duties, applicable to private sector pension plans, public pension plans, or both, are:

(1) the requirement that all pension plan activities be carried out in the sole interest of pension plan participants and beneficiaries;

(2) the requirement that all pension plan activities be carried out in conformance with the plan document governing the pension

plan unless the plan document is in conflict with an applicable provision of law;

(3) the requirement that there be named fiduciaries in the plan document or that a procedure be specified in the plan document for identifying fiduciaries;

(4) the requirement that any procedure for allocating pension plan responsibilities among fiduciaries be described in the plan document;

(5) the requirement that all pension plan activities be carried out with an understanding of the obligation of public trust that the fiduciary in the capacity of a public official owes to the citizens and the taxpayers of the jurisdiction in addition to the obligation owed to plan participants and benefit recipients;

(6) the requirement that all pension plan activities be carried out in conformance with the applicable laws and that no violation of the applicable law by any person is to be tolerated.

(7) the requirement that a trust be formally established for each pension plan;

(8) the requirement that the trust for the pension plan hold title to all of the assets of the pension plan other than those assets consisting of insurance policies or those held by an insurance company;

(9) the requirement that there be named trustees for the pension plan trust or that the trustees be appointed by a named fiduciary;

(10) the requirement that the investments of the pension plan be diversified to minimize the risk of large losses unless it is clearly determined to be imprudent to diversify;

(11) the prohibition on fiduciaries causing the pension plan to engage in various specified prohibited transactions, which include dealings with interested parties and self dealing;

(12) the prohibition on investing more than a specified percent of the assets of the pension plan in the securities or real property of any employing unit connected with the pension plan;

(13) the requirement that the indicia of ownership of the investment securities comprising the pension plan assets be maintained within the jurisdiction of the United States federal court system;

(14) the requirement that fiduciaries be bonded to a specified level, frequently based on the dollar amount of the assets of the pension plan;

(15) the requirement that pension plan investments conform with minimum liquidity amounts, generally in the form of maintaining minimum bank or trust deposits or cash equivalent investments;

(16) the prohibition on direct or indirect profit by the pension plan management personnel from the pension plan investment activity, the prohibition on pension plan management personnel dealing

on a basis other than with third parties in an arms length transaction, and the prohibition on plan management personnel self dealing;

(17) the requirement that persons connected with the pension plan publicly disclose any potential or actual interests resulting from personal investment holdings;

(18) the requirement that the pension plan pursue economic investment goals beyond those of the payment of benefits and reasonable administrative expenses, such as preferences for local corporate securities or other methods of investment targeting;

(19) the requirement that the pension plan pursue non-economic or social investment goals, such as the prohibition on investments in corporations that are doing business in certain countries, that are engaging in certain types of business, such as those involving alcohol or tobacco products, or that are subject to litigation over alleged violations of federal or state labor law, the federal occupational health and safety act, the federal age discrimination in employment act, or the federal equal employment opportunity act;

(20) the requirement that the legal title or ownership of all pension plan securities be clearly recorded in the name of the pension plan or its nominee; and

(21) the requirement that there be periodic disclosure of the identity of all investment advisors and brokers who are retained by the pension plan and the amount of any investment fees or commissions paid by the pension plan.

The various additional fiduciary duties that have been imposed historically are not all internally consistent and may actually run counter to the thrust of the general standard of fiduciary care, especially economically or socially targeted investments. The public pension plan management should attempt to identify those duties currently imposed on them by law or by their plan document and should consider the policy desirability of implementing those duties through state law or plan document amendments.

h. *Cofiduciary Responsibility.* Frequently included as a major element in fiduciary responsibility regulation is the specification of the role and responsibilities of cofiduciaries. This element covers the obligations that one fiduciary has regarding the actions of other fiduciaries. These obligations include the duty to monitor the actions of another fiduciary, the ability to delegate or allocate particular duties to another fiduciary without retaining a residual obligation, and the liability of one fiduciary who knows of, participates in or permits a breach of fiduciary duty by another fiduciary.

In most cases, a pension plan has more than one person who operates with the status of a fiduciary. If so, the various fiduciaries will then function in the capacity of cofiduciaries and will share in the responsibility of managing and operating the pension plan.

In actual pension plan practice, certain activities will be the joint responsibility of all fiduciaries of the plan, other activities will be delegated to agents, employees and functionaries, and still other activities will be formally or informally allocated among or between the various fiduciaries. In each case, the relationship between or among the fiduciaries will be different.

Where pension plan activities are the joint responsibility of all fiduciaries, the relationship among or between those fiduciaries is likely to be very different than that which would exist when the activities are delegated to other individuals or allocated between fiduciaries. While each fiduciary in a formal or technical sense has an equal role in the decision making process impacting on those activities, in practice, group dynamics come into play. Some members of the group of fiduciaries are likely to defer to other members of the group and thereby not undertake any direct personal responsibility for any actions taken. Other members of the group may choose not to function in concert with the majority of the group, but instead to undertake an independent or contrary view from the majority and thereby attempt to separate themselves from personal responsibility for the actions of the majority. Other members of the group of fiduciaries will undertake formal or informal leadership roles within the group, thereby increasing in a practical sense their responsibility for any actions taken. With the current minimal development of public pension plan fiduciary law in most jurisdictions, the imposition of fiduciary responsibility principles in light of these group dynamics is unclear.

Where pension plan activities are delegated to agents, employees or functionaries, the responsibility of the prime fiduciaries for these activities is likely to be chiefly or exclusively supervisory. Depending on the definition of fiduciary utilized, the persons to whom these activities are delegated may or may not be fiduciaries also. Where pension plan activities are allocated formally or informally between or among fiduciaries, the relationship among or between the fiduciaries will be altered considerably. Instead of a joint responsibility for various actions, with the allocation, the prime responsibility for the activity will lie with the fiduciary to whom it was allocated or by whom it was assumed. The remaining question is the residual responsibility for the activity that might remain with all other fiduciaries involved. If a public pension plan utilizes the allocation of fiduciary activities, the public pension plan management should attempt to identify the extent of protection from liability that follows the allocation, and if unclear, should attempt to clarify the process.

If there is a fiduciary breach by another fiduciary, cofiduciary responsibility principles require the cofiduciary to disclose the occurrence of the breach. The cofiduciary may also be required to attempt to correct the breach, including the initiation of a fiduciary lawsuit.

3. *Other Investment Regulations.* In addition to the traditional fiduciary responsibility regulations applicable to the pension fund investment function, other investment related regulation may exist and may give rise to responsibilities for pension plan governing boards and plan administrators. The regulation tends to be primarily statutory and tends to vary considerably from state to state.

The most commonly found public pension plan investment regulation beyond the traditional fiduciary regulation is the authorized investment security legal list. The legal list of authorized investment securities reflects concern on the part of policy makers about the extent of discretion given to pension fund investment officials and the manner in which those officials would exercise that discretion. The legal lists typically specify the types of investment securities in which a public pension fund may be invested. The legal lists also typically impose certain quality requirements and quantity restrictions for specified types of investment securities. Legal lists usually reflect a very traditional or conservative view of the investment process by avoiding investment securities that have relatively high risk of loss or relatively high volatility. Thus, before the 1960's, many public pension plans were subject to legal lists that either did not include any corporate issues, either equity or debt, or included only high grade corporate debt obligations. Legal lists in the 1980's frequently have been upgraded or modernized, but still typically lag behind recently developed investment instruments, such as non-investment grade corporate junk bonds, or recently developed investment approaches, such as venture capital funds or resource development limited partnership participation. Where a broader range of investment securities is included in a legal list, the legal list frequently will impact on the utilization of the full authority by requiring a particular level of quality (e.g., debt securities with certain quality ratings or equity securities of a corporation with a certain level of prior profitability or dividend payment) or by restricting the ability to increase or decrease amounts of investments in a short time (e.g., maximum increase or decrease in equity holdings not to exceed a certain percent per year).

The authorized investment legal list can function to augment the general fiduciary standard of care for investment activities or can function to actually supplant the general fiduciary standard of care for investment activities. If it augments the general standard, the legal list could require the plan governing board or administrator to invest in securities meeting the prudence rule, if applicable, and also meeting the requirements of the legal list. The augmenting legal list functions then to further reduce the universe of available investment securities from that remaining after the general standard of care, potentially leaving such a narrow universe of remaining investment securities that conformance with other fiduciary duties, such as diversification, may be impossible. If the legal list actually supplants the general standard of care, such as a targeted investment, the legal list adds considerable ambiguity to the undertaking of a plan official's duties. The supplanting legal list then functions to re-expand the available universe of investment securities, but also makes the general fiduciary standard of care for investment activities essentially meaningless. The question of whether the legal list augments or supplants the general standard of care depends on whether or not there must be compliance with both or primarily with the legal list.

In some jurisdictions, the additional public pension plan investment regulation is the extension to the public pension plan of the investment regulation developed for some other economic or financial organization, such as the investment restrictions for decedent estates, state chartered banks, insurance companies, or other public funds. As spin-off regulation, the provisions may not always be well adapted to the public pension plan setting. If the provisions are not well adapted on their face, the public pension plan management must attempt to make that adaptation. In any event, if spin-off regulation applies, the public pension plan management must be attentive to legislative, regulatory and judicial developments in this non-pension body of law.

E. Plan Administration Other Than Fund Investment

1. *In General.* Because of the magnitude of money involved and the risk of readily identifiable loss in the event of a misdeed by public pension plan management personnel, and because it is the traditional source of much administrative regulation, pension fund investment is typically viewed as the primary area of plan administration regulation. However, the area of fund investment involves a limited range of actual administrative activity by public pension plan management personnel, and, in most cases, is not the most important area of administrative activity for plan participants and benefit recipients. The investment of pension fund assets in its broadest view involves the timely provision of money into the investment process, the selection of the appropriate investment vehicle and the appropriate timing of the liquidation of investment securities. The investment of pension fund assets is of considerable interest to the pension plan sponsoring governmental entity, which typically insures the ultimate payment of pension plan benefits, but in a defined benefit pension plan rarely affects the amount of pension plan benefits to benefit recipients. For the plan membership, other aspects of plan administration have a more direct impact on the amount of pension benefits, or the ease in obtaining pension benefits, and on the sense of security or competence about the administration of the plan. These non-investment plan administration elements are derived from or give rise to legal obligations for plan administrators or plan governing boards.

2. *Non-Investment Plan Administrative Obligations.* The non-investment plan administrative obligations for plan governing boards or administrators arise out of the pension plan as a separate operational entity and out of the pension plan's special function to provide benefits to public employees. Several major areas are identified and briefly discussed in this section.

   a. *Record Keeping.* While record keeping is a necessary function for all organizations, the duty is of particular importance to pension plans. Eligibility for plan coverage, entitlement for benefits, benefit amounts, and benefit duration will be an outgrowth of or will be affected by the records kept on a plan member by the public pension plan. A pension plan member can easily be involved with a pension plan for 60 or 70 years, from the date of the person's entry into public service to the date of the person's eventual death, and longer if survivor coverage is involved. Record keeping broadly involves the creation of the initial record, with the procurement of a verification of age and related items, the retention of periodic reporting and any related updating, the verification of data items at key benefit and eligibility junctures, the retention of individual records upon membership termination, and any record retention requirements for all retirement plan records. For member-related records, the plan governing board and administrator must make all reasonable efforts to obtain accurate, timely, and complete records and to make all necessary updates. Member-related records must be retained for a considerable period of time even after the member terminates active service, and even after the payment of any available member refund, in the event that the member eventually returns to active service and the pension plan document authorizes the repayment of a refund. The plan governing board and administrator have a clear fiduciary duty to the affected member in record keeping, especially for a defined benefit plan, since either benefit eligibility, benefit computation, or both, will depend on that record keeping. Beyond member-related records is the question of overall record retention. If state or local law regulates record retention by public bodies, the plan governing board and administrator must comply with the relevant law. If no relevant law applies, the public pension plan management is under an obligation to establish reasonable internal record retention regulations and an internal record retention schedule.

b. *Communications, Reporting and Disclosure.* A well operated public employee pension plan will communicate extensively with its membership and will provide substantial information to its membership. Communications and information either will be routine or will be on request, and either will be general in nature or will be specific to the member. The routine communications with, reporting to, and disclosure to plan members by the plan governing board and administrator will generally consist of informational newsletters, benefit plan summaries, synopses of the plan's financial and actuarial reporting, and member account and benefit statements. Requested member-specific information will tend to be benefit estimations provided prior to retirement. An additional reporting and disclosure obligation will typically be the provision of the financial and actuarial reporting synopses to the membership of the pension plan, to the governmental and related entities in the pension plan and to the general public. In some states, the reporting and disclosure obligation is a legal requirement and will have minimum content requirements. Whether required by law or not, good fiduciary practice and good public policy require that plan governing boards and administrators provide a regular and substantial information flow to plan members and their governmental employers in order to facilitate the creation or maintenance of a knowledgeable plan membership, to allow for appropriate member scrutiny and to assist governmental employers in their financial reporting and disclosures. In all member-specific communications, the information must be prepared with due care and must be as accurate as is reasonably possible, since the member will likely rely on the information. Although the information may include a disclaimer that the specified benefit information is subject to correction at the time of actual benefit payment, the disclaimer may not actually relieve the pension plan from eventual liability in the event of a mistake or error unless the plan can demonstrate a high degree of care in both record keeping and information preparation. In the absence of this high degree of care, and with reliance by the plan member on any misinformation supplied by the plan, the plan will likely be bound by the misinformation, especially in the event of a recurring error.

c. *Accounting, Audit, and Actuarial Activities.* As a governmental entity, a pension plan will generally be subject by law to financial reporting and auditing. As a pension plan, especially if it provides defined benefit plan coverage, the plan will generally be required by law to have periodic actuarial valuations and experience studies. The financial reporting and actuarial valuation work complement and interrelate with each other, since the determination of a portion of the actuarial valuation results, such as the unfunded actuarial accrued liability and supplemental (amortization) contribution, will depend on sound financial reporting. Also, a growing portion of the comprehensive financial reporting of both the pension plan and the participating governmental employer or employers incorporates pension plan actuarial calculations. However, for many public pension plans, the actuarial calculations for financial reporting purposes under generally accepted government accounting principles may differ significantly from those for plan funding purposes. Actuarial calculations for accounting purposes frequently pursue public policy goals that are at variance with the policy goals underlying plan funding actuarial results. Sound public policy reasons exist for the generation of separate plan funding actuarial results.

Since the financial reporting and the actuarial valuation reporting may be the only items, or may be the chief items of communication with the financial community and the non-pension world at large, there are several important aspects to be considered. The first question relates to the qualifications of the accountant, auditor or actuary preparing the document. The plan governing board and administrator should exercise considerable care in the selection of these professionals, whether they are outside consultants or in-house staff. The public sector pension area has much in common with the private sector pension area, but there are key differences. A lack of familiarity or reduced sense of attention to these differences on the part of these professionals could seriously harm the reporting. The second question relates to the quality of the actual reporting, especially the procedures and techniques to be employed in preparing the reporting. While generally accepted public pension accounting principles are largely formulated, the accounting principles for various types of plans (such as cost sharing multiple employer plans, especially if collectively bargained) are less clear, and the generally accepted actuarial practices tend to be less well formulated. Adherence to sound general practices is important for a public pension plan. If a public pension plan chooses not to adhere to these practices or is not allowed by applicable law or its plan document to adhere fully to these practices, that non-adherence and its rationale should be fully disclosed in any reporting. The third question relates to the timeliness and quality of the underlying data, since the resulting processing and computations are unlikely to be useful if the underlying data either is not timely or is incomplete. The fourth question relates to the practice of preparing and responding to audit management letters, which may be provided by the independent financial auditors, and which may touch on actuarial practices as well as accounting practices. The public pension plan governing board and plan administrator should try to balance any normal defensiveness regarding this kind of scrutiny with a commitment to constantly seek administrative improvements.

d. *Benefit Information and Benefit Counseling Activities.* Since the pension plan exists primarily to provide benefits, the interplay between the plan governing board and plan administrator and plan members over the benefit coverage and individual benefit choices and options is very important. Although the pension plan may not have a positive duty to provide benefit counseling, the pension plan administration clearly has an obligation to provide information on the benefit plan to plan members. As part of regular communications, reporting and disclosure, plan members should be provided with a general estimate of their future benefits earned to date, projected to the plan's normal retirement age. These regular benefit estimations must be prepared with reasonable assumptions about future salary increases and must be based on current and accurate membership data. The underlying data should be summarized and the assumptions disclosed. Beyond the regular benefit estimations are specially requested benefit estimates. These requested benefit estimates typically occur near retirement age and are needed to cover retirement at various ages, to cover various optional annuity forms, and to cover the impact of any potential purchases of credit for prior service or refund repayments. The benefit estimates usually involve written communications, but benefit information provision also typically involves individual or group meeting sessions. The individual information sessions relate to meetings by the public pension plan staff with potential retirees either in the main office of the pension plan or in a remote location. For statewide pension plans that involve geographically dispersed membership groups, the pension plan governing board or administrator should establish sufficient remote information centers or periodic information sessions to make the services of the plan readily available to all potential retirees. Also, public meetings or group information sessions are useful in providing general plan information, especially following major benefit or administrative changes in the retirement plan. If any portion of the information task is performed by the governmental employing unit, the pension plan should attempt to assist the governmental employer to the extent possible in performing that function. If benefit counseling beyond information provision is undertaken by the pension plan administration, that counseling must be provided with due care. Liability for negligent benefit counseling may be imposed, with the pension plan typically bound by its mistake or misinformation.

e. *Benefit Payments and Benefit Processing.* Once a plan member retires, the pension plan has an obligation to pay retirement benefits to the retired member. The processing and payment of pension benefits raises various duties or obligations for public pension plan administrators and governing boards. The first issue is the question of the processing of the initial benefit payment. Although retirement could occur at any time throughout the year, retirements tend to be concentrated during certain time periods in many cases, especially the ends of school years, fiscal years, calendar years or collective bargaining periods. Aspects of the retirement plan or employment structure also work to concentrate retirements, such as the latest date occurring annually for inclusion in any future post retirement adjustments, or the settlement date of a collective bargaining agreement. With concentrated retirements, the problem arises of how quickly retirement benefits can be processed and what priority to be used in processing benefit applications within the group of applicants. Processing priorities should be clearly established by the public pension plan management, should be based on practical and non-discriminatory criteria, and should be readily disclosed to the plan membership. Beyond initial benefit processing concerns, the questions related to benefit payments are timeliness, the use of joint rather than individual accounts with direct deposits or electronic fund transfers, and the practice of out-of-state or foreign country benefit payments. Benefit payments should be paid in a timely fashion, and once a payment schedule has been established, departures from the schedule should be avoided to the extent possible because of the disruption that may be caused for benefit recipients and the potential for a negligence action to be commenced against the plan following a delay unless considerable care has been exercised. Procedures also must be established for the plan, and carefully followed, in making direct deposits or electronic fund transfers because of the departure they represent from individualized negotiable instrument processing. An outright ban on out-of-state or foreign country payments should be avoided, because they likely represent an unreasonable restriction on the right of free travel and because the associated problems can readily be overcome by utilizing relevant specific requirements, such as the use by benefit recipients of banks subject to the jurisdiction of the federal courts. Finally, adequate procedures should be implemented to monitor deaths among benefit recipients. Typically, public pension plan retirement benefits accrue and are payable for the life of the recipient. A failure to diligently monitor the continued existence and eligibility of recipients works an unnecessary monetary loss for the pension plan.

f. *Plan Interpretation.* Public pension plans generally are governmental entities with limited powers, and the benefit plan sets forth those powers and places limitations on their exercise. Good fiduciary responsibility procedures require that the benefit plan be interpreted in a manner consistent with the plan document. Plan documents that are set forth wholly or in part in statutes must be interpreted consistent with legislative intent under the relevant legal principles governing statutory interpretation. Plan interpretation is chiefly the province of the governing board of the plan and the plan administrator, with the assistance of competent legal counsel. Unless the benefit plan clearly indicates where the primary responsibility lies, the responsibility to interpret the benefit plan must be allocated between the governing board and the plan administrator. Where the specific language of the benefit plan document regarding a particular benefit is clear, interpretation is easy. When there are benefit plan ambiguities, the advice of the counsel for the benefit plan should be sought. If statute provisions are involved and an ambiguity arises, resort should be made to the established resolution procedure in that jurisdiction, which may provide for requesting an opinion of the state's Attorney General or seeking a declaratory judgement from a court of competent jurisdiction. The plan governing board or administrator should attempt to clarify ambiguous, conflicting or contradictory benefit plan provisions, and if statutory provisions are involved, should seek the necessary clarifying legislation. When assembling administrative legislation on behalf of the plan, the governing board or administrator should follow the impartiality and nondiscriminatory loyalty requirements that underlie sound fiduciary principles and seek administrative resolutions without favoring any discernible group of plan members or employing units.

g. *Status Determinations.* Benefit plan coverage in a public pension plan depends on status determinations arising out of eligibility provisions contained in the plan document. The plan administrator frequently will be the primary plan agent in making these status determinations, with the pension plan governing board functioning frequently in a supervisory role or a reviewing role. The primary power to make some status determinations may be delegated to the participating employing units, subject to plan review. These status determinations regarding plan membership, covered employment giving rise to service and salary credit, age and service retirement annuity eligibility, disability benefit eligibility, or survivor benefit eligibility must be made under sound fiduciary responsibility principles and sound government administrative law principles based on clear criteria and standards, adopted with compliance to appropriate procedures, published or otherwise accessible, consistently and uniformly applied, and open to review.

h. *Social Security Coverage.* In the public sector, coverage by the federal old age, survivors, disability and health insurance programs (Social Security) is not mandatory, but occurs by virtue of an agreement between the state or other employing entity and the federal Department of Health and Human Services. The existence of Social Security coverage may impose duties on the plan administrator. Where the extension of Social Security coverage depends on plan membership, determinations by the plan governing board or administrator or the question of plan membership have more implications and bring a greater obligation on the part of the public pension plan management to exercise due care. Where the absence or presence of Social Security coverage for public employees determines the benefit program within the pension plan applicable to the employee and the amount of eventual benefits payable, the plan administrator must also exercise due care to properly discern that coverage. If Social Security coverage is extended to a group not previously covered and a referendum on the Social Security coverage extension is conducted, the plan administrator will be responsible to assist in the process of counseling affected personnel about the consequences of their available choices. Finally, if the benefit plan provides for offsets from plan benefits for Social Security benefits payable, the plan administrator must correctly ascertain the amount of those Social Security benefits in order to fairly treat both the retirement plan and the member subject to the offset.

i. *Data Privacy.* As with any governmental agency or entity, public employee pension plans must obtain and disclose data on plan members and other individuals with regard to data privacy concerns. To the extent that federal law applies, a public pension plan is largely precluded from requiring that a person's Social Security number be disclosed by the person for a variety of administrative functions. However, as a payer of either refunds of previously non-taxed amounts or of benefits, a public plan is required to have the person's Social Security number for the applicable tax forms. To avoid requiring the disclosure of a plan member's Social Security number, a public pension plan would be well advised to establish a separate plan identification numbering system or comparable procedure for various administrative uses, such as the validation of governing board member election ballots or benefit applications. If there is state legislation governing governmental data collection and disclosure, the plan must comply with the regulation. Even if state data privacy legislation does not specifically apply because of the nature of the pension plan as a legal entity or ambiguities in the data privacy legislation, the duty of loyalty to plan members encompassed in public pension plan fiduciary responsibility principles requires considerable care and respect for the privacy of data on plan members be observed, especially in the disclosure or use of that data. Data disclosure and use is both internal to the plan and external to other governmental units and others. The use of membership data for internal purposes will generally be unrestricted so long as no unauthorized disclosure outside the plan would occur. Care must be exercised with the disclosure of data to contractors and consultants, such as accounting and actuarial personnel, and to other governmental units, such as state taxation or revenue authorities. Disclosure of data on an individual member, except to the member or to others with the member's consent, should not occur unless clearly provided for in law, such as disclosures in the event of marriage dissolution or child support actions. Any disclosure should occur only to the extent specified in law.

j. *Board Elections and Vacancies.* In many public pension plans, the chief policy making function and frequently the chief administrative management function is vested in a board of trustees, board of directors, or other governing board designation. A number of aspects related to the governing board can give rise to legal responsibilities and liabilities for governing board officers, other governing board members and the chief plan administrator. For a pension plan that has a governing board that includes elected board members, legal responsibility and liability issues include the determination of the eligibility of a candidate to seek election, the enforcement of any candidate reporting and filing requirements, the conduct of board member election campaigns, including any candidate information distribution by the plan, the procedures governing the conduct of the board member election, and the process for filling governing board member vacancies. To the extent that the plan document or applicable governing law specify or clearly delineate these procedures and processes, there should be rigorous attention and adherence given to those provisions. Failure to comply with these provisions can potentially invalidate the selection of one or more governing board members, can potentially invalidate various subsequent actions of the governing board, and can subject the remaining board members or chief administrative officer to liability for resulting invalidated actions or omissions. This is especially the case if the process and procedural violations, misdeeds or omissions are done knowledgeably, deliberately, or intentionally. For a pension plan with appointed governing board members, the chief issues concern the eligibility of a potential appointee and the adherence to any appointment procedures. Eligibility requirements may include limitations on the number of appointed board members of a particular political party affiliation or limitations on past connections by a potential board member with the plan or an employing unit or on current connections by a potential board member with a business that is a potential vendor to the plan. Some pension plans utilize ex-officio board members. A question arises about the powers of those members and the obligation of other board members to include those members in board deliberations and in the normal board member information flow. Although in some jurisdictions and contexts it is the situation that ex-officio members have become synonymous with honorary or non-voting members, the term "ex-officio" should not connote anything other than the manner of selection (from a given office) and ex-officio governing board members should be accorded full rights, privileges and access unless the plan document or governing statutes clearly specify otherwise.

k. *Administrative Organization, Staffing and Employment.* The administrative organization of the staffing of a pension plan and employment by a pension plan can give rise to legal obligations and responsibilities of the plan governing board and administrators. The plan, and hence its governing board and administrators, have an obligation to have a clear administrative structure, with appropriate lines of authority, supervision and oversight, appropriate staffing, and clear terms and conditions of employment. The absence of these items likely will lead to a finding of negligence or impropriety on the part of the board or administrator and potential liability for subsequent actions or omissions. The plan should have designated officers (president or chair, etc.) to conduct board meetings and functions and should have specified standing and ad hoc committees to handle its various duties in a knowledgeable and deliberate manner. It should have a plan administrator if the size of the plan and its administrative duty load exceeds the load that a board officer can reasonably be expected to perform. There should be a selection criteria and process for both the internal plan administrator as well as any external plan managers, consultants and advisors. The authority for employing additional staff should be clearly delineated in the plan management structure, as should the organization of the duties of those employees, their reporting lines, their supervision, and their back-up. If the public employer or employers participating in the pension plan have a civil service system or have stated personnel policies, those should either be extended to the plan employees or the plan's personnel system or policies should be developed and adapted in light of the general employing unit practice applicable to plan members. Education on employment duties or functions on a progressive basis should be established for both the governing board and plan employees so that each person's duties and responsibilities are fully understood and suitable responses are coordinated.

l. *Pension Plan Rulemaking.* As essentially administrative agencies of state or local government, public pension plans frequently have the authority to make rules. Generally, that rulemaking authority is vested to the governing board of the public pension plan. There is both a procedural and a substantive component to rulemaking. The failure to comply with procedural requirements or the pursuit of substantively inappropriate subjects or elements in rulemaking will bring potential legal consequences, Generally, state law sets forth a process for rulemaking, frequently known as the "administrative procedures act" or the "administrative code". If the statutory rulemaking procedure applies to the pension plan, then all pension plan rulemaking should be done in accord with that act. If the statutory rulemaking procedure does not clearly apply to the pension plan, the plan would gain a more defensible legal position if it followed the rulemaking procedure in any event or if it incorporated as many aspects of the procedure into its own procedure as are applicable or appropriate. The procedural safeguards of any administrative procedures act may delay the pension plan rulemaking process, or may cause the plan or the sponsoring governmental unit or units to expend additional resources, resulting in some tension or difficulty. However, the procedural safeguards included in the administrative procedures act have been developed as good public policy in regulating this function and compliance brings a certain protection from procedural challenges or reduces the extent of novel legal arguments required to be formulated in the event of a procedural challenge. From a substantive standpoint, pension plan rulemaking should not conflict with the plan document or applicable governing law and should not be used to expand plan authority into new areas outside the plan's clear legal authority. Rulemaking is derivative authority and may occur only if the plan has authority to issue rules derived from the applicable law and only if the rulemaking builds on or fills in gaps in existing statutory authority. Public pension plans typically have limited legal authority, reflecting their specific rather than general purpose for existence. As such, rulemaking should occur within a traditional or designated zone of authority.

m. *Budget Setting.* The governing board of a public pension plan, based on proposals formulated by the plan's chief administrative officer, typically establishes the administrative budget of the plan. The budget setting activity can give rise to legal obligations to both the chief administrative officer and the governing board with respect to a number of items. First is the source of the administrative budget, and, if a common plan administration for multiple pension plans is involved, the allocation of the administrative budget amount among the various pension plans. If the administrative budget is payable from a pension plan, those expenses are payable from a dedicated fund or trust and consequently must meet the necessity and reasonableness tests. Second is the authority to set the administrative budget. The budget must be set by the appropriate authority, typically the governing board of the plan, and must be in accord with any applicable procedures and must be subject to any applicable review or approval process. Third is the extent of actual conformity with the budget during the budget period. Because it represents an apportionment of limited resources among various potential expenditure items, a budget is a policy document. The plan administrator and remaining administrative activity must conform with the budget, must establish adequate controls to monitor expenditure levels, and must follow established procedures for obtaining approval for a significant budget departure. Fourth is the use of investment soft dollars and other non-budgeted resources and expenditures. Non-budgeted resources and expenditures should be avoided to the extent possible by a public pension plan in its role as a public entity, since good public policy emphasizes advance budgetary approvals, clearly defined expenditure limits, and openness. Fifth is the process of funding capital expenditures. Unlike most governmental entities, which have clearly limited annual resources and a self evident need for spreading the cost of capital expenditures over a period of time, public pension plans have or should have a substantial accumulation of assets to offset accruing actuarial liabilities. Hence, public pension plans can potentially afford to undertake and immediately fund capital expenditures from the plan's assets, such as the purchase of a computer system or the purchase of an office building. However, simple fund availability is not the only policy issue at stake and the potential investment opportunity loss from an immediate expenditure must be balanced against the financing costs of various longer term financing arrangements. Sixth is the relative size of the budget. The primary purpose of a public pension plan is to provide retirement benefits, and not to maintain an administrative structure or finance an investment operation. Hence, the administrative expenses of the public pension plan should not total a significant percentage of covered payroll when compared with the actuarial cost of the benefit plan and should not be a significant dollar amount on a per plan participant basis.

n. *Legal Activities and Response to Legal Proceedings.* Because the pension plan engages in various legal activities and is subject to various legal proceedings, the pension plan governing board and plan administrator must undertake the appropriate duties. The pension plan typically has the power to sue and be sued in a court of law, either directly or on a derivative basis from the governmental entity sponsoring or maintaining the plan. If the power is direct, the pension plan can sue and be sued in its own name. If the power is derivative, the pension plan can only sue and be sued in the name of the governmental entity. If the power is derivative, the plan governing board and administrator has a responsibility to coordinate its activities with the governmental entity. Additionally, the pension plan usually has access to legal counsel, either through the direct retention of its own legal counsel or through referral to the legal counsel of the governmental entity. Much of the litigation in which a public pension plan will be engaged potentially will relate to benefit eligibility and benefit amounts and will involve its own members, potential members, or beneficiaries. With potential litigation in which the plan is a defendant or respondent, the plan governing board and administrative should develop clear policy on when potential settlements will be considered and the general form, content and substance of any potential settlements, subject to any applicable law. In legal proceedings involving other parties, the pension plan may be involved because of its financial or legal relationship with one of the parties, its current or future obligation to pay benefits to one of the parties, and the value of that obligation. These proceedings usually will involve garnishment actions, child support actions and marriage dissolution actions. The proceedings also may involve investment activities. Usually, public pension plans are not required to respond to garnishment, levy or execution orders unless some public debt is involved. Public pension plans will differ in their treatment of court-ordered child support, marriage dissolution actions, responses to qualified domestic relations orders, bankruptcy actions, and tax liens.

o. *Legislative Representation and Advocacy.* To the extent that the public pension plan is a creature of state or local law and depends on legislative enactments for all or part of its benefit plan document, the plan through its governing board or plan administrator will engage in legislative representation and advocacy. This legislative representation and advocacy brings with it duties, responsibilities, and potential problems for the plan governing board and administrator. Local or state legislative activities in which a public pension plan could engage run the range of the provision of information regarding pending legislation, the submission of requests for necessary or desirable administrative changes and provisions, and the advocacy for or against legislation with a substantive policy component. The provision of information on pending legislation is a clear duty of the plan management, as is the submission of administrative change proposals that do not involve a substantial policy component. More problematic is the question of the active advocacy for or against policy legislation relating to pension benefits or broader policy areas. Advocacy activities may be problematic for the pension plan management. Advocacy activities may involve the expenditure of pension plan time and resources in a manner that might not directly benefit the persons or entities to whom the plan owes a fiduciary duty. They may involve issues that may unequally affect those persons or entities to whom the plan owes a fiduciary duty. Unequal treatment runs the considerable risk of violating both public pension fiduciary principles and constitutional principles. Some pension plan governing boards and administrators may feel that it is their fiduciary duty to engage in extensive legislative advocacy activities over legislation involving substantive policy. This tends to occur if the relationship between the plan and the applicable legislative body is very adversarial, the substantive policy issues arise in the context of actual or attempted pension underfunding by the legislative body, the legislative body appears to be inattentive to perceived substantive policy needs, and no employee organization or other advocacy vehicle exists as an alternative means to further the issue. The plan governing board needs to assess its desired and appropriate role in undertaking legislative advocacy, especially if the advocacy is likely to enter into benefit issues and is likely to disproportionately impact on one segment of the plan membership or is likely to reduce the financial solvency of the plan.

p. *Taxation Question.* Federal and state taxation issues arise in connection with public pension plans and the public pension plan governing board and plan administrator must determine their obligation to address or respond to these issues. As indicated earlier, public pension plans are not held to the full extent of regulation under Employee Retirement Income Security Act of 1974 (ERISA), as amended, as are private sector pension plans. However, there is a question of compliance with those federal Internal Revenue Code and related provisions that do apply, with a duty to keep abreast of federal tax law changes and interpretations. Where the benefit plan is contained substantially in state or local enactments, conforming changes by the pension plan will require action by an entity outside the plan and hence become more uncertain, both as to ultimate substance and timing. If federal tax law compliance requires detrimental modifications in benefit plan provisions, state constitutional provisions, state law provisions or state judicial rulings may restrict or prohibit full compliance. Beyond federal law compliance is the question of reporting to the federal Internal Revenue Service, to any comparable state or local tax authorities, and to the plan participant. There is an obvious duty on the part of the plan management to be both accurate and timely in any reporting that they undertake. A plan governing board or plan administrator should be careful in undertaking duties that are not mandated by the plan document or other applicable law or regulation, since any undertaking will be expected to be performed with due care. If the plan management explicitly or implicitly indicates that it has expertise in the area, its performance will be expected to be conducted with expert care. There are a large range of income tax related issues. An example of one is that of accounting for any member contributions to the pension plan once a member retirees. If the pension plan is a contributory plan, meaning that employee or member contributions were or are required, the plan management must exercise considerable care in keeping track of those contributions for tax purposes and calculating any federal income taxation exclusion ratios, especially if the plan implemented the employer "pick-up" of employee or member contributions under section 414 (h) of the federal Internal Revenue Code.

q. *Disaster Planning.* The governing board and the administrator of a public pension plan should assemble a plan for the operations of the pension plan in the event of a disaster. The ongoing operational purposes of a pension plan are the payment of benefits to retired members, the processing of benefit application for retiring members and the appropriate record keeping related to active members. Those plan functions must be fulfilled in the event of disasters, and the plan management must take steps to minimize the disruption caused by a variety of disasters and to be able to restore functions as soon as possible following a disaster. The plan management needs to address issues such as the protection and rehabilitation of the pension plan administrative facility, the preservation of pension plan records and data reporting, and the continuation of benefit payments in the event of power failures, communication disruptions, floods, fires and other natural calamities. Failure to undertake disaster planning or negligence in formulating or implementing disaster planning will likely subject the plan management to liability for omitted benefit payments following a disaster and to administrative inconvenience and potential liability for benefit processing interruptions and record keeping errors or failures caused by a disaster.

r. *Interrelationships with Other Programs and Activities.* Although the payment of pension benefits, the processing of benefit applications, and the collection of appropriate records are the primary operational functions of a pension plan, a pension plan may be interrelated with other non-pension programs and activities, and the plan management may undertake certain responsibilities and obligations with respect to those programs and activities. The plan management must balance a competent, timely and appropriate exercise of these other program and activity functions with the exercise of pure pension related functions, so that the non-pension functions do not threaten, substantially diminish or impair pension functions. The non-pension functions can include programs and activities such as the access to health insurance by retirees and benefit recipients, the interrelationship between workers compensation benefits and pension plan benefits, the interrelationship between the disability benefit coverage and any publicly financed employment or physical rehabilitation programs, the interrelationship with the personnel systems of the various employing units connected with the pension plan, including enforcement of any applicable mandatory retirement provision, the administration, management or functioning of any state aid program dedicated for pension purposes, and the involvement in enforcement procedures related to the collection of debts owed to the state or a government subdivision.

3. *Remedies and Enforcement of Non-Investment Plan Administrative Obligations.* While some of the particular remedies or means for the enforcement of plan administration obligations other than pension fund investment were detailed above, a general discussion of remedies or enforcement measures in general is appropriate.

   Remedies or enforcement measures in the event of a failure to conform with non-investment plan administrative obligations can be generally categorized as a compulsion of performance, the imposition of a monetary award, the transfer of functions to another administrative entity, or the removal of the plan official from that position. The compulsion of performance will generally be in the form of a mandamus action. The mandamus action is a court order to an official requiring that person to complete a ministerial duty or be held in contempt of court. The key to deciding a mandamus action is the character of the duty, for if it is discretionary with the official, the official cannot be compelled to undertake the action. The imposition of a monetary award is the traditional grant of monetary damages, generally based on the loss suffered by the plaintiff as a result of the impropriety. The transfer of functions to another administrative entity recognizes that there is hierarchy in governmental functions and that an agency to whom the pension plan owes a reporting obligation can be held responsible to perform certain functions in the event of the non-performing management of a public pension plan. Finally, a non-performing public pension plan manager can be removed from that position, thereby initiating a different course of administrative action.

V. Protection from Liability or Enforcement of Remedies Regarding Public Pension Plan Action

A. In General

As indicated earlier, service as a member of a public pension plan governing board or public pension plan administrator brings with it substantial responsibilities and obligations. As a position with substantial responsibilities and obligations, deficient, negligent or inappropriate actions in that capacity will bring with them either liability or the application of other remedies. The public pension plan management can protect itself from this liability or against enforcement of these other remedies by undertaking several actions.

This section attempts to indicate several key strategies or actions that can afford a public pension plan governing board or manager some protection from liability or other remedy for those public pensions activities. A public pension plan governing board or administrative officer can take certain steps to minimize liability or the application of other remedies for pension administrative activities, can obtain insurance or indemnification against liability for pension administrative activities, can identify and cultivate defenses against liability or the application for other remedies for pension administrative activities, or minimize the applicability of other remedies for pension administrative activities.

B. Prevention of Liability or the Application of Other Remedies

1. *Responsibility and Obligation Identification.* There are a number of ways in which a member of a public pension plan governing board or a public pension plan administrator can minimize potential liability or can make other remedies inapplicable. First and foremost in this protective strategy is the identification of the various responsibilities and obligations of the governing board or administrator of the public pension plan and the acquisition by those affected of a clear understanding of what those responsibilities and obligations entail. Ignorance will not function as a defense, since the law looks to the relationship between the public pension plan management and the plan, its participants and its sponsoring employers as one encompassing the highest degree of care and considers the plan management to be professionals and hence to be held to a professional standard. The public pension plan should assemble a checklist of duties, obligations and responsibilities that are generally applicable to the plan management and those that are applicable to specific plan management positions.

2. *Continuing Education.* This process of identification and understanding naturally leads to the practice of initial and continuing education of pub-

lic pension plan governing board members and chief plan administrators. New members of the public pension plan governing board, especially those whose membership is a function of their official position (ex-officio members), are unlikely to bring an extensive or detailed understanding of the duties, obligations and responsibilities of the public pension position with them when they first undertake the position and hence will need an appropriate overview of their activities. Incumbent public pension plan governing board members may need refresher reviews of their role and function and will also need to keep abreast of new developments in the field. Administrators should have substantial initial familiarity with public pension plan management, but also need to explore new developments. The public pension plan should formulate a policy or program of initial and continuing plan management education. The complexity of the program will depend on the asset size and the membership size of the pension plan, the nature of the benefit plan, and the manner in which the plan is funded. Actual practice can range from in-house discussion and overview sessions to the utilization of outside experts or developed courses, seminars and conferences sponsored by the various organizations representing public employee retirement systems, such as GFOA.

3. *Proper Allocations and Delegations.* A third strategy is the clear allocation or delegation of duties among the plan management. With the proper allocation of duties, such as the assignment of the investment function to an investment committee of the governing board, other governing board members will generally not be held accountable for day-to-day activities. They generally will only be held accountable for general oversight and monitoring. With a proper delegation of duties, such as the clear assignment of benefit counseling duties to the appropriate plan administrative official, the various pension plan activities will consequently be well organized and the officials dealing in a peripheral area will be alerted not to overstep their function. A proper delegation will also allow plan officials who deal in specialized pension areas to be insulated from liability for other functions and it may protect the plan and other management officials from the imposition of liability in the event of incorrect or incomplete performance by those officials. Allocations and delegations of duties should be in writing, periodically reviewed and updated, and communicated generally. This communication function is best carried out by the development and publication of a clear organizational chart for the plan. When dealing with outside vendors, consultants and advisors, the contract or arrangement should clearly specify the appropriate contact personnel and the persons connected with the plan who are entitled to assign duties or approve transactions. Approval procedures, once established, should not be circumvented, and, if obsolete, should be revised in a timely fashion. Clear allocations and delegations thus should function to avoid potential liability situations such as those in which plan participants receive incorrect benefit information from plan investment personnel, where low level benefit information personnel can direct the sale or purchase of investments of the plan or make capital expenditures, or in which necessary plan functions, such as governmental reporting or tax filings, go unperformed over long periods.

4. *Use of Appropriate Expertise in the Decisionmaking Process.* A fourth strategy is for the plan governing board, plan administrator and other plan management officials to make use of the appropriate expertise in the deci-

sionmaking process within the pension plan. The use of this expertise should occur early in the decisionmaking process, before major policy and related decisions are finalized. The formulation and use of a well-defined decisionmaking process will be a strong defense, since courts are reluctant to substitute their judgment for an administrative decision unless the decision is arbitrary and capricious. A well-defined decisionmaking process that actually is used is unlikely to be found to be arbitrary and capricious. A pension plan typically will have access to substantial expertise, either through in-house staff or outside consultants and authorities. These include the plan's legal counsel, investment advisor, investment performance evaluator, actuary, accountant, auditor, and medical evaluator. In addition, if the pension plan enters into an unfamiliar area, such as direct real estate investments or coordination of its disability program with a vocational rehabilitation program, the plan will need to utilize specialized counsel or consultants. The person plan management should identify those types of policy and related decisions that will require the use of expertise and should establish a procedure for incorporating expertise into the plan's decisionmaking process.

5. *Written Communications as Standard Procedure.* A fifth strategy is to institute a pension plan practice of using written communications for all major plan activities. This is especially important in the benefit information area, where at a minimum, written communications should be used to confirm any basic information related in person or over the telephone as a routine practice and a copy of that communication should be retained in the files of the plan. Oral communications can easily be misunderstood, especially if technical benefit plan terms (such as the terms "vesting requirement", "allowable service" or "normal retirement age") underlie the question or the answer. A general practice of reducing all essential information to writing and routinely filing a copy of the communication that is sent to a participant will provide the court with the basis for relying on the writing rather than the more uncertain oral communication in the event of litigation. Where possible, other pension plan transactions should be in writing or reduced to written summaries. While this may be somewhat cumbersome with items such as investment transactions, the process produces a paper trail for all transactions that will allow for monitoring, oversight and ascertaining that all necessary and appropriate approvals have been secured.

6. *Coordination With Benefit Plan Document.* A sixth strategy is to reconcile all written communications provided to plan participants regarding the benefit plan with the benefit plan document. A court will generally view a benefit booklet or other written communication on the benefit plan as a legal document that is binding on the pension plan. Hence, the plan must take all appropriate measures to eliminate any conflicts. Communications also must be periodically reviewed and updated to incorporate any plan changes, especially if some benefits have been placed on a phase-out basis or discontinued in favor of other benefit changes. Booklets and other written communications should include a clear disclaimer in the event that a conflict with the benefit plan document does exist or if the item attempts to discuss state or federal tax consequences. While courts are frequently reluctant to broadly enforce disclaimers, especially if the disclaimer is relied on by the plan to overcome sloppy written work, the disclaimer may assist an eventual successful argument to a court by the plan if the disclaimer

is prominently displayed, there exists an alternative means for gaining relevant personal information that is generally accessible, considerable care was used by the plan in preparing the communication item, and the conflict between the communication and the benefit plan was one that was not readily apparent during the publication period.

7. *Appropriate Activity Levels.* A seventh defensive strategy is for public pension plan personnel to ascertain the appropriate level of their activities. The benefits and the operational capabilities of the pension plan should not be overrepresented, and the abilities of the governing board member or administrator should not be overextended. Current trends in investments, mortality, salary increases and inflation tend to be transitory and should not be the basis for long term advice on benefits or investment practices. If benefit practices are discretionary with the sponsoring employing unit, the state legislature or the plan governing board, care should be used in order to avoid giving plan participants and benefit recipients assurance on future practices, since these assurances may be considered by a court to be binding in future litigation. Tax laws, Social Security laws, other applicable federal laws and the administrative practices of other agencies and entities also tend to change rapidly and may not be fully consistent. Plan personnel should be cautioned about attempting to summarize these laws and practices and about attempting to apply them with any specificity, since there exists a considerable chance that plan participants will be misled. Thus, achieving an understanding of the plan's limitations, such as its ability to keep pace with post-retirement inflation for instance, and of the person's own limitations, such as the person's familiarity with the details of the Social Security program governmental benefit offsets for instance, will prevent future misinformation to which plan or personal liability may attach.

8. *Good Faith Actions; Absence of Personal Benefit in Undertaking Actions.* The final defensive strategy for public pension plan governing board members and administrators is to always act in good faith and to avoid basing actions on personal benefit. If a potential action raises any questions in the mind of the official, the official should document those misgivings, should object based on those misgivings where possible on the record, should vote or act against questionable activities and, if no other course of action presents itself, institute a legal challenge to the action or resign the position. In the event of a later controversy over an action, it is not likely that legal responsibility for the action and any consequent liability will be found if the official acts in good faith and clearly departs from questionable activities at the earliest available occasion. Members of the plan governing board and the plan administrator must be aware of the favors or perquisites that can accompany their position and must avoid any favor, perquisite, personal benefit, or personal advantage becoming the basis for undertaking any plan action or making any plan decision. If no general governmental law or policy on the acceptance of gifts or favors applies, the pension plan governing board should formulate an appropriate policy.

C. Liability Insurance and Indemnification

In the event of a controversy over public pension plan actions, benefits and activities, there will be the question of the responsibility for the alleged misdeed or omission and the question of the remedy to be imposed. The remedy will usually be monetary damages. While responsibility for an alleged problem may give rise to moral concerns or concerns about a person's professional reputation, the chief concern for many public pension plan officials is the possibility for and the extent of liability for the payment of money damages. Indemnification by either the pension plan or the sponsoring employer liability insurance will address this area of chief concern.

Indemnification of a public pension plan official can be provided by the pension plan or by one or more sponsoring employing units. Indemnification means that any liability of a plan official for money damages will be assumed by the plan or by the employing unit. Indemnification assists the officials involved and assists the plan or sponsoring employing unit by allowing for greater success in the recruitment or retention of plan officials. On the other hand, indemnification increases the risk that plan officials will be more careless in performing their duties because of the absence of personal liability.

Liability insurance for a public pension plan official also can be obtained by the official, the plan or a sponsoring employing unit from an insurance carrier. The coverage is generally available in the private sector, where the federal Employee Retirement Income Security Act (ERISA) has largely defined plan official responsibilities, duties and obligations, and is also available in the public sector. However, the coverage may have limitations and gaps for public pension plans because of the lack of clearly defined responsibilities, duties and obligations or of the existence of different duties, obligations for public pension plan officials. Unlike indemnification, liability insurance does not raise the question of conflicting incentives, since the premium for the liability insurance will be a function of the claims experience of the plan, its insurability rating, and its perceived commitment to good practice and due care.

In some jurisdictions, governmental entities self-insure or participate in self-insurance pools for a variety of tort liability situation. Given the limitations of, gaps in, or problems with fiduciary liability insurance, a public pension plan may seek to self-insure against its potential fiduciary liability or to extend self-insurance pool coverage to fiduciary liability issues.

D. Defenses Against Liability and Other Remedies

1. *Sovereign Immunity.* There are several defenses that a public pension plan official can assert in the event of a challenge to an action of the official or of the plan. One defense against a challenge to public pension plan actions is the doctrine of sovereign immunity. Broadly, the doctrine holds that the government cannot be bound to answer for its actions in a private lawsuit. The doctrine is an adaptation of a long standing feature of English law, where the monarch was considered to be above legal action by a private citizen. The doctrine of sovereign immunity, however, is eroding both by legislative and court action. Further confusing attempts to assert the doctrine is the question of the governmental nature of public pension plan, since sovereign immunity is frequently limited to purely governmental acts and not to proprietary actions, and since some public pension plans can be structured in the form of instrumentalities owned by the public sector or in the form of separate, nominally independent, nonprofit corporations. Also, several states that have modified the doctrine of sovereign immunity allow litigation with a very low or modest maximum on permissible monetary damages.

2. *Public Officer's Immunity.* Similar to the doctrine of sovereign immunity is the defense of officer's immunity, under which governmental officials are viewed as having absolute immunity from litigation challenging any

alleged tort committed while performing their official actions. This defense is also eroding, and the governmental official may be required to prove good faith actions in order to utilize the defense. The defense may only apply to small scale errors, and is likely not to apply if the official violates state or local statute, or when the official exceeds the scope of the position's discretion.

3. *Plaintiff's Lack of Standing.* Another defense is the lack of standing on the part of the plaintiff to assert the claim. As a practical matter, not every misdeed, irregularity, or error will result in a claim, simply because no injured plaintiff exists to press the claim. Thus, when a public pension benefit increase is enacted in violation to a "one subject" state constitutional requirement for legislative enactments, but with the support of the plan, the participants and the associated employing units, there may be no party with a sufficient interest in the matter to raise the question in litigation. Similarly, in a cost sharing multiple employer public pension plan, the determination that a marginally disabled person is sufficiently disabled to be entitled to a disability benefit may also lack any party sufficiently interested in the potential error to litigate the issue. Even if there is an interested party, the party will be required to have a sufficient stake in the alleged inappropriate action to have standing to bring the litigation or resources to afford the costs of the litigation. With plan participants' denied benefits, the injury is clear and standing to litigate the benefit denial easy to establish. Potential negligence involving an investment opportunity in a multiple employer defined benefit pension plan, however, will produce a less clear injury and no potential party may have a sufficient interest in the alleged error to have standing to pursue the suit.

4. *Statute of Limitations.* A fourth potential defense is the failure of the plaintiff to initiate the lawsuit before the statute of limitations period has expired. State law will vary on the length of the statute of limitations period, based on the nature of the claim, and may have a special statute of limitations period for actions against a governmental entity or agency. Tardiness in pursuing an action as measured by the statute of limitations period will terminate all possibility of litigation, no matter how meritorious the litigation may be. The statute of limitations may toll for a variety of reasons (e.g. mental incapacity, absence from the state), but undiscovered fraud appears to be the only generally applicable tolling event for public pension plan litigation.

5. *Failure to Notify the Government Entity.* A related potential defense is the failure of the plaintiff to give notice to the governmental entity of a claim against the entity as required by state law. This provision applies to alleged torts committed by the government or governmental officials. Without a waiver granted by the court where good cause exists for the failure, a failure to comply with the statutory notice provision will bar the action.

6. *Failure to Exhaust Administrative Remedies.* A sixth potential defense is the failure by the plaintiff to exhaust administrative remedies for the alleged pension problem. A public pension plan should have an administrative appeals process and a plan participant who is the potential plaintiff must utilize that process before undertaking litigation. A failure to use the plan's appeals process will not necessarily be a permanent bar to subsequent litigation, but will likely delay the litigation until the internal appeal process has been completed.

7. *Assertion of Counterclaims.* A final potential defense is the pursuit of potential counterclaims by the public pension plan official, if applicable. In any litigation between two parties, the defendant can assert against the plaintiff any counterclaims that the defendant may have, even if unrelated to the initial claim by the plaintiff. Thus, if a plan administrator responding to a public pension plan based cause of action has a dispute over an unpaid debt with the petitioner, a counterclaim based on that debt can be asserted in answer to the initial action. This potential counterclaim may function to dissuade the potential plaintiff from pursuing the initial cause of action.

E. Minimization of Liability

Liability or the application of other remedies may be minimized by public pension plan governing board members or administrators in a number of ways.

The remedy sought in a challenge to a public pension plan action can be minimized or even avoided by a demonstration that any incorrect action was reasonable or rational, and by reliance on the natural aversion of the court to attempt to substitute its judgment for that of the management of a public pension plan. The burden typically borne by the plaintiff in litigation is the demonstration that the administrative action was more than incorrect and that it was either arbitrary or capricious or lacked a substantial basis for action. If the defense can clearly shift this burden to the plaintiff and then subsequently substantiate the reasonable basis for the plan administrative action, even if admittedly incorrect in hindsight, no liability or other remedy may in fact be imposed by the court.

If monetary damages are to be imposed, perhaps from a situation such as the denial of a pension benefit, the damages can be reduced by demonstrating that the plaintiff had the opportunity to mitigate or reduce the amount of damages and that the plaintiff failed to do so. This mitigation may entail a delay in the effective date of retirement, the payment of omitted contribution amounts or the refiling of accessary documents or reprovision of necessary information.

VI. Conclusion

Although the members of public pension plan governing boards and plan administrators have numerous legal obligations, duties and responsibilities, the performance of these duties, obligations and responsibilities is manageable if prudence and care are exercised and any consequent litigation over and liability from that performance can hence be avoided.

The amount of litigation relating to public pension plan activities is historically small, given the number of public pension plans and plan participants involved. While considerable attention to affairs is expected of public pension plan officials, they can meet that expectation by keeping reasonably well informed about applicable pension and related developments, by paying strict attention to the benefit plan document and other relevant laws, by observing consistent operating practices, and by acting in good faith.