Section III: Issues Remaining to be Resolved/Addressed

19. Issues Remaining to be Resolved

20. Issues Remaining to be Addressed

Chapter 19:

Issues Remaining to be Resolved

Investment Authority

A major issue discussed at length and yet to be resolved is who would have investment authority and responsibility for the assets of the fund. Should the Permanent Board of the restructured teachers retirement plan have authority and responsibility for investing the assets of the fund or should investment authority reside with the State Board of Investment (SBI)?

The investment management of pension trust fund assets is a vital source of long-term funding stability for public employee pensions. As the world of investment opportunities becomes more complex, sound investment policies and professional expertise are essential to achieve return objectives. The net assets of the four teacher retirement systems as of July 1, 2001, are:

TRA	$	15,092	million
Duluth	$	266	million
Minneapolis	$	1,062	million
Saint Paul	$	824	million

The investment management authority and practices of the four teacher retirement associations are very dissimilar. Since its formation in 1931, the assets of TRA are invested under the authority of the State Board of Investment (SBI). The SBI is established in the Minnesota Constitution, Article 11, Section 8, to manage the investing of all state funds. The duties and powers of the SBI are specified in MN Statutes, Section 11A.04. The SBI sets major investment policies, contracts with qualified private money management firms, and employs an Executive Director and staff to oversee these activities.

In contrast, boards of the three first class city retirement systems are charged with investment under their articles of incorporation and bylaws, and the authority of MN Statutes. Similar to the SBI role, the boards themselves set investment policies and asset allocation targets, contract with money management firms, and regularly review performance of investment activity.

While the duties and powers of a sound investment strategy have been established through both theory and practice, the main questions this report leaves unanswered is: Which entity is charged with the legal responsibility to perform these duties?

Structure of Permanent Board

In Chapter 8, considerable discussion is made regarding the size and composition of the Board of Trustees that would govern the restructured teachers retirement plan for years to come. Board composition was reviewed both at the national level, as well as comparison of the current board structures of the four Minnesota teacher plans. Consensus on the structure of the Permanent Board is yet to be achieved.

Structure of Transition Board

As discussed in Chapter 8, a key component to the restructured teachers retirement plan would be a Transition Board that must be in place as the restructured plan is being implemented, and prior to the election and appointment of the Permanent Board.

Although there was considerable discussion among the fund directors regarding the composition of the Transition Board, no consensus was reached as to its exact structure. There are, however, a number of consensus items regarding the ultimate structure of the board, including:

- A Transition Board should be slightly larger (11-13 members) than the Permanent Board;
- Member representation from each of the four systems should be included;
- Retirees should be represented;
- Employer representation should be included;

Active and retiree member representatives would be appointed by the respective boards of the four funds.

Discussion will continue toward reaching a consensus on this sensitive issue.

Proposed Timeline

Included in the legislative mandate for preparing this restructuring report is the requirement that the report include a detailed schedule and timeline. There was much discussion on what should be an appropriate timeline, but consensus could not be reached by the directors.

Chapter 20:

Issues Remaining to be Addressed

Although much time and effort was put into this report, there were not only issues that were discussed and unresolved but also issues that the authors did not have an opportunity to sufficiently address. These issues appear in list form below. Some of these issues are local and administrative in nature (e.g., how would current employees in each fund be protected?) and other issues are more global (e.g., what could be added to the fund to retain teachers?).

It is the consensus of the authors that these issues must be addressed before the final legislative restructuring could take place.

Issues remaining to be addressed:

- Should there be auxiliary offices (e.g., Duluth)?
- Could calendar and fiscal years of service be merged?
- Should definition of salary be modified (e.g., coaches' bill, statewide median salary)?
- What would happen to current staff members and how would they be protected?
- How would current boards be held harmless in a restructuring?
- How would assets be transferred, at what valuation?
- Does the restructured plan need a new IRS qualification?
- What would be the process for dissolving the current nonprofit corporations?
- How would current benefits be protected?
- Should there be a supplementary add-on plan to bring retired teachers back into teaching to help with the teacher shortage issue?
- Should there be disability options or should current provisions be modified?
- What could be offered for phased retirement?
- If a plan is underfunded, how would the assets be divided between active and retiree members?
- If a plan has surplus assets at the time of the restructuring, how would those surplus assets be preserved for the exclusive benefit of the members of the plan?

Other issues may be added as discussions continue.

Section IV: Steps to Restructuring

21. Implementation Process

22. Authorizing Legislation

Chapter 21:

Implementation Process

One of the critical issues involved in the restructuring deals with how to go from the current four teacher plans into one restructured teachers retirement plan. Since the three first class city funds were incorporated under Chapter 317A, which is the Minnesota Nonprofit Corporation Act, their dissolution or merger would have to be done in accordance with that chapter. This is especially important to the current trustees of the teacher plans, since they must be held harmless if restructuring occurs.

One of provisions of Chapter 317A has been discussed in detail by the authors and that is the provision that provides for a vote by the members. Each of the first class city teacher funds would have to ratify the dissolution or merger of their old plans to the new restructured teachers retirement plan. This ratification process has been incorporated into the proposed timeline for restructuring.

Since the TRA is currently a governmental agency, it is not anticipated that its membership would vote on the restructured plan.

The authors anticipate that the employers would want to ratify the restructured plan since they are responsible for any liabilities created by the restructured teachers retirement plan. A more detailed discussion of the actual implementation steps has not taken place.

Below is a summary of some key citations from Chapter 317A, which should serve as a further guideline to restructuring as it affects the first class city funds as nonprofit corporations.

Merger, Consolidation, Dissolution Laws Affecting Minnesota Nonprofit Corporations

Organizational Background. Minneapolis, St. Paul and Duluth teachers' retirement funds were originally created under MN Laws 1909, Chapter 343, which authorized their formation.

The 1909 enabling act has been amended several times. The establishment provision found in MN Statutes, Section 354A.021, subd. 2, of that section further provides that teachers' retirement fund associations in cities of the first class "shall be organized and governed pursuant to this chapter and Chapter 317A," which is the Minnesota Nonprofit Corporation Act.

Merger, Consolidation. MN Statutes, Sections 317A.601 through 317A.671, govern merger, consolidation and transfer of assets of a nonprofit corporation.

A. Two or more corporations may merge or consolidate, resulting in a single corporation. Section 317A.601, subd. 1.

B. A plan of merger or consolidation must be approved by each constituent corporation. Section 317A.613, subd. 1.

   1. When a constituent corporation has members with voting rights, the plan of merger or consolidation must be submitted to a vote of the members with voting rights, and unless the articles of incorporation require a greater vote, the plan of merger or consolidation must be approved by a majority of the members who vote. Section 317A.613, subd. 2.

Effect on Corporation

1. In the case of a merger, one of the constituent corporations is the surviving corporation. In the case of a consolidation, the surviving corporation is a new corporation. Section 317A.641, subd. 2(1).
2. The agreement of merger or consolidation may provide for the continued existence of a constituent corporation in the merged corporation for purposes declared in the agreement. Section 317A.641, subd. 2(3).
3. The surviving or new corporation has all the rights, privileges, immunities, powers and franchises of each constituent corporation. Section 317A. 641, subd. 2(4) and (5).
4. All real or personal property, debts and interests belonging to each constituent corporation are transferred to the single corporation without further act or deed. Section 317A.641, subd. 2(6).
5. Debts and liabilities of each constituent corporation become the debts and liabilities of the single corporation, as if the single corporation had contracted them. Section 317A.641, subd. 2(9).

6. The rights of creditors or liens upon the property of a constituent corporation are not impaired by the merger or consolidation, but the liens are limited to the property upon which there were liens immediately before the merger or consolidation. Section 317A.641, subd. 2(12).

Effect on Fiduciary Capacity. Under Section 317A.641, subd. 3(b), the single corporation is the successor of the constituent corporations in fiduciary capacities in which a constituent corporation was acting at the time of the merger or consolidation "and is liable to the beneficiaries as fully as if the constituent corporation had continued its separate corporate existence."

Assets not to be Diverted. Under Section 317A.671, when a corporation dissolves, merges or consolidates, assets of the corporation or a constituent corporation "may not be diverted from uses and purposes for which the assets have been received and held, or from the uses and purpose expressed or intended by the original donor."

Dissolution. MN Statutes, Sections 317A.701 through 317A.791, govern dissolution of nonprofit corporations. Dissolution is not discussed in detail here. It is noted that if the corporation has members with voting rights, a proposed dissolution must be submitted for approval at a meeting of such members. Section 317A.721.

Chapter 22:

Authorizing Legislation

BE IT ENACTED BY THE LEGISLATURE
OF THE STATE OF MINNESOTA:

CONTINUING STUDY FOR CREATION OF A
RESTRUCTURED MINNESOTA
TEACHERS RETIREMENT PLAN

Section 1. [PURPOSE AND INTENT.]

The executive director of the teachers retirement association, the executive secretary of the Duluth teachers retirement fund association, the executive director of the Minneapolis teachers retirement fund association, and the executive director of the St. Paul teachers retirement fund association shall continue the process of establishing a nonprofit corporation that will provide retirement, survivor, disability benefits and ancillary benefits to eligible public school teachers in the state of Minnesota. This nonprofit corporation shall be the successor to the current teacher retirement funds that exist in the state of Minnesota and shall be created to accomplish the tenets that have been proposed in the report titled "Restructuring of the Minnesota Teacher Retirement Plans."

Section 2. [SCOPE.]

The directors shall be charged with the following duties:

1. Continue to consult with a task force consisting of representatives of the affected employing units and representatives of the collective bargaining groups representing members of the affected pension plans.

2. Prepare and propose a timeline for the accomplishment of the necessary steps to establish the new restructured teacher retirement fund association after the enactment of permissive legislation.

3. Prepare a draft of proposed legislation that would be required to accomplish the establishment of a restructured teacher retirement fund association.

Section 3. [DURATION.]

The directors shall present to the chair of the Legislative Commission on Pensions and Retirement the final draft of the proposed legislation that would be required to establish a restructured teacher retirement fund association, no later than January 15, 2003.

Appendix A

- Analysis of Minnesota Small Systems and Minnesota TRA Pension Funds
- Funding History of the Teacher Pension Plans

Analysis of Minnesota Small Systems and Minnesota TRA Pension Funds

(as of June 30, 2001)

	Duluth TRA	St. Paul TRA	Minneapolis TRA	Minnesota TRA
Total Net Assets (in millions)[1]	$ 266.7	$ 824.2	$ 1,062.0	$ 15,092.0
Annual Covered Payroll (in millions)	$ 50.4	$ 199.0	$ 267.9	$ 2,812.0
Annuity Payroll (in millions)	$ 14.3	$ 53.3	$ 110.0	$ 861.7
Administrative Expenses	$419,807	$ 444,000	$ 627,000	$13,077,718
Administrative Expenses as a % of Payroll	0.79%	0.22%	0.26%	0.46%
Funding Ratio	107.6%	81.9%	65.95%	105.8%
Contribution Sufficiency/(Deficiency)	4.71%	1.26%	(2.73%)	2.15%
Total Active Members	1,427	4,671	5,813	71,097
Old Plan (Duluth)	309	NA	NA	
Basic Plan (Minneapolis/St. Paul)	NA	575	614	
Coordinated Plan	1,118	4,096	5,199	
Inactive Members	828	2,248	3,052	27,801
Retired Members/Survivors	1,058	2,050	3,444	33,757
Retired	992	1,807	3,161	31,169
Survivors/Disabilitants	66	243	283	2,588
Contribution Rates				
Employee	5.50%	5.50% *C*	5.50% *C*	5.00%
Employer	5.79%	8.34% *C*	8.14% *C*	5.00%
Annual Employer Additional Contribution[2]	$ NA	$ 4,577,000	$ 21,244,000 [3]	$ NA
State		$ 3,777,000	$ 17,194,000 [3]	
School District		$ 800,000	$ 2,025,000 [3]	
City			$ 2,025,000 [3]	
Board Structure	**9 trustees** 7 elected members 1 school bd member 1 superintendent or designee	**10 trustees** 9 elected members 1 school bd appointed	**7 trustees** 6 elected members 1 school bd appointed	**8 trustees** 5 elected members 3 ex-officio - Comm. of Finance - Comm. of CFL - MN School Bd Assn

[1]Defined Benefit Plan Assets

[2]Result of Legislature in 1993, 1996 and 1997; see history of funding for detailed information

[3]2002 maximum per statute

C = Coordinated Plan

Historical Contribution Rates and Funding*

	2000	1998	1997	1995	1994	1990	1984	1983	1979	1978	1974	1973
Duluth												
Employee	5.50%	5.50%	5.50%	5.50%	4.50%	4.50%	4.50%	4.50%	4.00%	4.00%	4.00%	4.00%
Employer**	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	6.50%	5.00%	5.00%
Additional	0.92%	1.01%	1.01%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	12.21%	12.30%	12.30%	11.29%	10.29%	10.29%	10.29%	10.29%	9.79%	10.50%	9.00%	9.00%
Total Required	8.51%	10.24%	12.87%	13.23%	10.36%	10.70%	13.26%	13.82%	10.08%	10.72%	9.50%	10.27%
Sufficiency/(Deficiency)	3.70%	2.06%	-0.57%	-1.94%	-0.07%	-0.41%	-2.97%	-3.53%	-0.29%	-0.22%	-0.50%	-1.27%
Funding Ratio	103.77%	95.13%	85.97%	82.12%	97.50%	93.61%	65.40%	67.40%	79.70%	79.70%	88.70%	92.30%
St. Paul												
Employee	6.05%	6.21%	6.38%	5.99%	6.15%	6.50%	7.05%	7.19%	7.52%	7.63%	8.00%	7.00%
Employer**	9.07%	9.26%	9.40%	9.54%	8.94%	9.14%	10.42%	10.74%	11.51%	12.63%	13.50%	12.00%
Additional	2.17%	2.12%	3.46%	0.34%	0.36%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	17.29%	17.59%	19.24%	15.87%	15.45%	15.64%	17.47%	17.93%	19.03%	20.26%	21.50%	19.00%
Total Required	16.57%	18.82%	18.45%	17.96%	18.63%	18.86%	16.25%	26.44%	26.12%	25.69%	24.17%	21.62%
Sufficiency/(Deficiency)	0.72%	-1.23%	0.79%	-2.09%	-3.18%	-3.22%	1.22%	-8.51%	-7.08%	-5.42%	-2.67%	-2.62%
Funding Ratio	80.32%	72.55%	69.11%	70.41%	68.28%	63.68%	55.20%	46.30%	40.70%	39.30%	36.10%	34.20%
Minneapolis												
Employee	6.10%	6.44%	6.63%	6.33%	6.25%	7.10%	8.02%	8.11%	8.40%	8.50%	6.50%	6.50%
Employer**	8.95%	9.34%	9.53%	9.80%	9.89%	10.26%	12.29%	12.48%	13.14%	13.35%	15.89%	14.65%
Additional	8.20%	9.61%	12.45%	2.87%	3.02%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	23.25%	25.39%	28.61%	19.00%	19.16%	17.36%	20.31%	20.59%	21.54%	21.85%	22.39%	21.15%
Total Required	25.25%	25.80%	28.23%	25.18%	25.03%	30.40%	34.45%	41.13%	35.59%	32.64%	21.57%	21.43%
Sufficiency/(Deficiency)	-2.00%	-0.41%	0.38%	-6.18%	-5.87%	-13.04%	-14.14%	-20.54%	-14.05%	-10.79%	0.82%	-0.28%
Funding Ratio	66.54%	63.91%	57.37%	56.44%	55.86%	49.96%	45.30%	38.20%	41.20%	42.40%	57.00%	56.90%
Minnesota TRA												
Employee	5.00%	5.00%	5.00%	6.51%	6.51%	4.58%	4.71%	4.73%	4.30%	4.32%	4.40%	4.45%
Employer**	5.00%	5.00%	6.64%	8.15%	8.15%	8.22%	9.19%	7.78%	7.30%	7.32%	5.90%	5.90%
Additional	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	10.00%	10.00%	11.64%	14.66%	14.66%	12.80%	13.90%	12.51%	11.60%	11.64%	10.30%	10.35%
Total Required	7.92%	9.82%	9.85%	14.30%	14.73%	13.11%	14.55%	18.63%	17.15%	15.14%	15.63%	14.12%
Sufficiency/(Deficiency)	2.10%	0.20%	1.79%	0.36%	-0.07%	-0.31%	-0.65%	-6.12%	-5.55%	-3.50%	-5.33%	-3.77%
Funding Ratio	105.21%	105.70%	101.30%	85.91%	83.51%	77.60%	59.60%	57.10%	51.20%	54.30%	50.00%	53.40%

* Historical contribution rates as determined by annual actuarial valuations or LCPR summaries.

** Employer contributions include employer supplemental

Notes:

1998 TRA over 100% funded; employer supplemental contribution eliminated (reduction of 1.64%)

1997 TRA employer supplemental contribution lowered by 1.5%. These contributions were dedicated annually to the following:
Duluth $486,000, St. Paul $2,827,000, Minneapolis $12,954,000, PERA $15,885,000

1990 TRA employer supplemental reduced by 0.84%

1984 TRA receives additional supplemental contribution from state 1.49%

1978 New Coordinated plan begins for Minneapolis & St. Paul (Duluth in 1981). Employer supplemental eliminated for St. Paul & Minneapolis Coordinated.

View additional funding information in Chapter 5.

Appendix B

First Class City Teacher Retirement Funds
Phase-Out Consolidation Options:
Technical Advisory Group
Report to the Legislative Commission on
Pensions & Retirement (March 16, 1994)

Summary of Findings

Purpose and Scope

This report is provided by the Technical Advisory Group as part of a study mandated by the 1993 Legislature to examine phase-out or consolidation options for the First Class City teacher retirement funds. We identify and analyze an array of fourteen distinct options relating to alternative plan structures, fund consolidations, management and financing arrangements, including the *status quo* as both an option and a baseline against which to assess others.

No recommendation is made in this report. The Technical Advisory Group intends simply to provide policymakers with the most thorough and objective information that can be obtained on the options identified as worthy of consideration. What follows is an attempt to synthesize the best empirical information and professional assessments of these options attainable given the time and resources available.

Fourteen options were identified and selected for assessment ranging from maintaining the current plan, funding and management arrangements, to total and immediate consolidation of the four teacher retirement plans in the state. Between these extremes lie twelve alternatives on a continuum of progressively more fundamental and sweeping plan/funding modifications. This report evaluates, along with fund elimination options, proposals that address concerns about cost effective administration and investment management, along with alternative funding scenarios driven partly by bonding opportunities to arbitrage downward the projected unfunded liabilities of several plans: An approach that could have significant positive impacts on the funding status of the Minneapolis and St. Paul funds in particular.

We break the options into 3 (overlapping) categories:

1) Administrative Efficiency Opportunities

2) Funding Change Opportunities

3) Actual Plan/Fund Modification Opportunities

Current Status

The "Current Status" section of the report lays out the situation faced by the teacher funds as a whole and separately. The major point to be drawn from our appraisal of the situation is that Minnesota teacher retirement liabilities are, on the whole, very well funded. Ninety percent of the active teacher fund members are in adequately funded plans. There are serious ongoing deficiencies, however, in two local plans, Minneapolis ($9,813,284 per year) and St. Paul ($4,333,485 per year), in which approximately 10% of the active teachers and administrators participate. This point is worth emphasizing: If policymakers believe that funding is the primary issue of concern regarding teacher funds in the state, then the response should be focused as closely as possible on the genuine locus of the funding problem. It may be the case that consolidation of poorly funded plans with well-funded plans could expand the scope of the problem, rather than containing and resolving the issue of central concern.

Benefits do not appear to be the driving force behind the current funding problems. One summary way to compare benefits is to look at the **normal cost of retirements**. From this perspective, current benefits among the various plans are quite similar in terms of *total* cost. There are significant differences among the plans in terms of *specific* benefits, but from a total cost perspective there do not appear to be large, overall benefit disparities.

There are significant differences among the funds in terms of administrative costs, both as a percentage of payroll, and in terms of annual expenditures distributed by plan membership. Administrative costs range from 0.83% of annual payroll (Duluth) to 0.15% (TRA). This can be accounted for partly by economies of scale, but also appears to be driven by different division between internal/external service provision. In addition, fixed costs in the smaller plans have a smaller base against which to be distributed, and therefore, would, under any level of efficiency in operations from a variable cost perspective, probably always be higher.

Certainly, opportunities for long-run economies in administration exist. The issue for policymakers, however, is whether the potential savings are worth the transition costs, or possible member service and policy implications of any administrative consolidation.

Analysis of Options

Consolidation or phase-out of First Class City pension funds appears to be very costly under each scenario evaluated. These options are also more controversial, long-term and complex to implement than others considered.

Aside from the many policy considerations presented to policymakers by the options evaluated, there seem to be very few opportunities for actual plan or fund *consolidation* that do not also imply significant actuarial costs. Unless some of these issues can be resolved through legislation on plan consolidation provisions, it does not appear that reducing the number of funds creates economies in strict cost/benefit terms to the state or the employing jurisdictions. Some other superseding policy objective would be required to justify the fiscal impacts presented here. Issues that deal with some of these other dimensions are more thoroughly addressed in the following section of the report.

Consolidation or phase-out of the three first class city funds is projected to be very costly. The new first year cost ranges from $29 million for Option 8 to $65 million under Option 13. The Commission actuary did not perform the valuations necessary to derive cost figures for Option 14, but it is safe to assume that the costs for this option would certainly exceed those for Option 13.

For other options that fall generally within the "Consolidation Opportunity" category, the first year costs are larger than we anticipated. The costs are most often due to differences in the assumed rates of return on pre/post-retirement assets, funded status of the plans, and diminishing active payroll to support closed plans as they approach the amortization target date. By far the most expensive options are #12 and #13. Allowing only actives to elect current or TRA benefits and SBI post-retirement adjustments (Option #12) raises first year costs from $28.8 to $55.8 million; a difference of $27 million. Under Option #13, we extend to retirees the election on post-retirement benefits, which increases projected required contributions by $9.2 million. Primary factors driving these results are:

1) Moving members from plans that are poorly funded into well-funded plans;

2) allowing the election of SBI or 13th check post-retirement increases; and,

3) the lower assumed post-retirement rate of return for the State TRA versus local fund rates.

Changes in funding arrangements, such as issuing taxable general obligatio bonds to finance part of the unfunded liabilities of plans in need, and reallocation of current contribution amounts, present opportunities to improve the funded status of plans without additional costs to the state, employers, or employees. These benefits under these options rely more, however, on forecasted debt service costs and returns on assets.

Of the fourteen alternatives, there are only three where costs (as measured in terms of required contributions) are actually reduced - Options 2, 3, and 4.

Options #3 and #4 (affecting only MPLS-TRA and MERF) involve a "contribution lock-in, and G.O. bonding of unfunded liabilities. These are the only alternatives to current policy that the Advisory Group studied that show some promise of significantly reducing retirement obligations. Detail cash-flow projections are included in the appendix to this report which illustrate the actuarial effects under Options #3 and #4.

First-year "savings" under option #3 are estimated at $5.4 million. Savings here, is measured against the current combined total deficiency for the relevant funds. A reduction in deficiencies is defined here from an actuarial perspective as "savings." From a strict fiscal and budgetary point of view, expenditures are not really reduced under Options #3 or #4.

The next option, adds to this scenario the issuance by the school district and city, taxable general obligation bonds to offset the unfunded liabilities of the MERF and MPLS-TRA funds. The text runs to date have been for sales of $100 million each for the two funds. The spread between the rate of return on the assets obtained, and the rate of interest on the bonds creates an arbitrage opportunity. A large amount of assets are infused into the funds, and compound at a rate sufficient to double the effect of the contribution lock-in; savings are $11.5 million the first year.

The effect of all this on MPLS-TRA can be understood as a reversal of the current situation, where insufficient assets come into the fund each year, and the loss is negatively compounded by the rate of return that could have been obtained. In this case, a significant share of that contribution insufficiency is corrected, such that the deficiency for MPLS-TRA goes from 6.80% to 2.23% with the lock-in and bond sales. The funding problem for MPLS-TRA is not resolved entirely under these projections, but if recent investment performance of the two funds (well in excess of assumed returns) can be sustained for even the next few years, the effect could be even more dramatic. Certain technical problems need to be resolved before either or both of these options could be implemented, and these are discussed further in the "Option-by-Option Analysis" section of the report.

Administrative costs are not significant in terms of overall funding requirements. Under virtually every option we studied, administrative savings were assumed liberally, but were never sufficient to offset much larger adverse actuarial impacts of consolidation options. Where administrative savings were not reversed by actuarial effects, they do not appear large enough to warrant the operational disruptions and up-front costs implied.

Administrative costs simply do not amount to much in the pensions context. The estimated administrative savings in the table for Options 2-5 are based upon analyses by MERF and MPLS-TRA. The amount saved by sharing certain administrative functions and office space is approximately 5%. For Options 6 and 7, affecting only the four teacher funds, we assumed 20% savings in administration, and 10% on investment costs. These are beyond the item-by-item projections for MERF and MPLS-TRA. We felt that a significant amount should be assumed given the more similar nature of the plans being managed. For the remaining options, we assumed a 10% savings in overall administrative costs. Larger memberships and greater geographic dispersion of employers/members, the scale of operations and systems, and the complexity of administrative arrangements could render these assumptions invalid, and in fact, cause *diseconomies*.

The administrative savings under Options 2 ($300,000) are so minor that they could easily be eliminated by incorporating effects on overall fund and employer administrative costs that have *not* been included in this report. Administrative savings under Option #5 ($608,000) are dwarfed by the actuarial costs of the proposal. While significant administrative "savings" occur under Option #6 ($1,755,000) they are similarly wiped out by actuarial costs.

While members of the advisory group are by no means unanimous on this point, it appears that member services would either be enhanced or at least not substantially impaired in the long-run by most of the options we considered. Options 6 and 7, however, and perhaps 12 and 13, centralize administration of the plans, and in doing so, could limit member access to fund management and staff. Where problems such as member access, service levels, or potential technical/administrative issues appear, we have noted this in the "Option Impacts" and "Option-by-Option Analysis" sections of the report. There are significant transition issues and costs associated with consolidation of administrative functions. These are easily identified by the people who actually administer the current four funds. Putting monetary value on them, or defining timelines to implementation, are more difficult and speculative tasks.

Where plans are consolidated or phased-out, issues to be resolved are many and complex, particularly as regards election of benefits, asset transfer ratios, along with establishing base pensions, and financing post-retirement increases.

For any of the actual plan/fund consolidations, a common problem exists: How does a 13th check operate if a fund is closed to new members, and active members or retirees are either re-directed to another plan or allowed to elect another's benefits? The base of contributions, asset accumulation, and thus capacity to generate excess returns available for distribution, would be considerably reduced. In a closed fund, there would be no new actives, and therefore a shrinking pool of assets against which to draw 1% for distribution. Funding the 13th check becomes difficult without some other infusion of contributions to the fund. The issue also remains as to how the 13th check, which for many older retirees is now larger than their retirement benefit, would be converted into a base pension within the Post Fund.

Wherever there are benefit changes (except for #14, the "Best of All Plans" option), there are typically *both* winners and losers. This report attempts to show which group outweighs the other for each option. Where there is expected to be a significant number of members potentially affected either way, that information is presented. While none of the options seems to imply reductions for the majority of the affected members, any occurrence of reduced benefit (i.e., transfers of member assets at less than the *pro rata* share from their current fund) could be litigated by members if the plan selection was not optional. Where there appears to be potential for litigation, we have either marked the column with a negative sign or question mark.

Appendix C

Uniform Management of Public Employee Retirement Systems Act (UMPERSA) — 1997

UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-SIXTH YEAR
IN SACRAMENTO, CALIFORNIA
JULY 25 - AUGUST 1, 1997

WITH PREFATORY NOTE AND COMMENTS

UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

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UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

PREFATORY NOTE

State and local retirement systems currently manage in excess of $1 trillion in assets for the benefit of participants and beneficiaries. The well-known federal law regulating the management of retirement funds, the Employee Retirement Income Security Act (ERISA), does not apply to these systems. ERISA §§ 3(32), 4(b), 29 U.S.C. §§ 1002(32), 1003(b) (1994). Instead, the systems are regulated by law in each State. That law varies considerably across States and has often failed to keep pace with modern investment practices. The Management of Public Employee Retirement Systems Act (MPERS Act) will modernize, clarify, and make uniform the rules governing the management of public retirement systems.

In broad terms, the MPERS Act protects participants and beneficiaries of public retirement systems in two ways. First, the Act articulates the fiduciary obligations of trustees and others with discretionary authority over various aspects of a retirement system and ensures that trustees have sufficient authority to fulfill their obligations (Sections 4 through 10). Second, the Act facilitates effective monitoring of retirement systems by requiring regular and significant disclosure of the financial and actuarial status of the system, both to participants and beneficiaries directly and to the public (Sections 12 through 18).

Considered in more detail, the Act's regulation of the management of public employee retirement systems can be divided into six categories. First, the Act requires that all retirement system assets be held in trust (Section 4). Second, the Act ensures that the trustee has exclusive authority over those assets (Section 4) and sufficient control over the enterprise to manage the assets efficiently and effectively (Sections 5 and 6). Third, the Act articulates the duties of trustees and others with discretionary authority over the operation and administration of a retirement system or the management of its assets (Sections 6 through 10). Fourth, to facilitate effective monitoring of retirement systems, the Act imposes significant disclosure requirements. The Act clarifies the application of state open record and open meetings laws to retirement systems (Section 12) and requires systems to publish various types of reports (Sections 13 through 18). The reports must be distributed widely and be made available to the public (Sections 13 through 15). Fifth, the Act has provisions to permit effective enforcement (Sections 11, 19, and 20). Finally, the Act prohibits the assignment or alienation of benefits, unless the legislature expressly decides that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits (Section 21).

A primary purpose of this Act is to facilitate the incorporation of modern investment practices into state law regulating the management of public employee retirement systems. Since the late 1960's, the investment practices of fiduciaries experienced significant change. These changes occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory." The law of trust investment has been modernized to keep pace with these changes, and the National Conference has actively participated in the effort. Restatement (Third) of Trusts: Prudent Investor Rule (1992) (hereinafter "Restatement of Trusts 3d: Prudent Investor Rule"); Uniform Prudent Investor Act (1994) (hereinafter "Uniform Prudent Investor Act"); Uniform Principal and Income Act (1997).

The Act is designed to replace laws that inhibit or, in a number of States, even prevent use of modern investment practices. In the long run, these outmoded laws result in billions of dollars of lost opportunities for investment income. The lost income could be used to increase pension benefits, lower contribution rates, or some combination. The immediate beneficiaries would be the system's participants and beneficiaries, but the ultimate beneficiary would be the State's taxpayers. Taxpayers could offer employees either a better pension for the same cost or the same pension for a lower cost.

The Act facilitates the incorporation of modern investment practices, in large part, by revising and clarifying the standards of prudent retirement fund investing. Five generally accepted principles of modern fiduciary investment practice are implemented. All are found in the Restatement of Trusts 3d: Prudent Investor Rule and all derive from the Uniform Prudent Investor Act, another National Conference initiative to incorporate modern investment practices into state law:

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the retirement system setting, the term portfolio embraces the assets of each retirement program or appropriate grouping of programs. MPERS Act § 10(2).

(2) The tradeoff in all investing between risk and return is identified as the trustee's central investment consideration. MPERS Act § 10(2).

(3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the program and that meets the other requirements of prudent investing. MPERS Act § 8(a)(4).

(4) The long-familiar principle that trustees diversify their investments has been integrated into the definition of prudent investing. MPERS Act § 8(a)(2).

(5) The power of a trustee to delegate investment and management functions is affirmed, clarified, and subjected to safeguards. MPERS Act § 6.

For a discussion of these principles as they appear in the Uniform Prudent Investor Act, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641 (1996).

These standards of prudent investing apply to retirement system trustees. Consequently, they can only be effective in incorporating modern investment practices into the retirement system setting to the extent trustees have the independence and institutional resources necessary to comply. The Act contains provisions that protect the ability of trustees to manage retirement system assets in accordance with the prudence standards of this Act and, hence, in accordance with modern investment practices. MPERS Act §§ 4-6. At the same time, the Act facilitates effective monitoring of trustees by requiring significant openness in the operation of retirement systems. MPERS Act §§ 12-18.

UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

SECTION 1. SHORT TITLE. This [Act] may be cited as the Uniform Management of Public Employee Retirement Systems Act.

SECTION 2. DEFINITIONS. In this [Act]:

(1) "Administrator" means a person primarily responsible for the management of a retirement system or, if no person is clearly designated, the trustee of the system who has the ultimate authority to manage the system.

(2) "Agent group of programs" means a group of retirement programs which shares administrative and investment functions but maintains a separate account for each retirement program so that assets accumulated for a particular program may be used to pay benefits only for that program's participants and beneficiaries.

(3) "Appropriate grouping of programs" means:

(A) for defined benefit plans, a cost-sharing program or an agent group of programs; and

(B) for defined contribution plans, a group of retirement programs which shares administrative and investment functions.

(4) "Beneficiary" means a person, other than the participant, who is designated by a participant or by a retirement program to receive a benefit under the program.

(5) "Code" means the federal Internal Revenue Code of 1986, as amended.

(6) "Cost-sharing program" means a retirement program for the employees of more than one public employer in which all assets accumulated for the payment of benefits may be used to pay benefits to any participants or beneficiaries of the program.

(7) "Defined benefit plan" means a retirement program other than a defined contribution plan.

(8) "Defined contribution plan" means a retirement program that provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account; any income, expenses, gains, and losses credited or charged to the account; and any forfeitures of accounts of other participants that may be allocated to the participant's account.

(9) "Employee" includes an officer of a public employer.

(10) "Fair value" means the amount that a willing buyer would pay a willing seller for an asset in a current sale, as determined in good faith by a fiduciary.

(11) "Fiduciary" means a person who:

(A) exercises any discretionary authority to manage a retirement system;

(B) exercises any authority to invest or manage assets of a system;

(C) provides investment advice for a fee or other direct or indirect compensation with respect to assets of a system or has any authority or responsibility to do so; or

(D) is a trustee or a member of a board of trustees.

(12) "Furnish" means:

(A) to deliver personally, to mail to the last known place of employment or home address of the intended recipient, or, if reasonable grounds exist to believe that the intended recipient would receive it in ordinary course, to transmit by any other usual means of communication; or

(B) to provide to the intended recipient's public employer if reasonable grounds exist to believe that the employer will make a good faith effort to deliver personally, by mail, or by other usual means of communication.

(13) "Governing law" means state and local laws establishing or authorizing the creation of a retirement program or system and the principal state and local laws and regulations governing the management of a retirement program or system or assets of either.

(14) "Guaranteed benefit policy" means an insurance policy or contract to the extent the policy or contract provides for benefits in a guaranteed amount. The term includes any surplus in a separate account, but excludes any other portion of a separate account.

(15) "Insurer" means a company, service, or organization qualified to engage in the business of insurance in this State.

(16) "Nonforfeitable benefit" means an immediate or deferred benefit that arises from a participant's service, is unconditional, and is enforceable against the retirement system.

(17) "Participant" means an individual who is or has been an employee enrolled in a retirement program and who is or may become eligible to receive, or is currently receiving, a benefit under the program, or whose beneficiaries are or may become eligible to receive a benefit. The term does not include an individual who is no longer an employee of a public employer and has not accrued any nonforfeitable benefits under the program.

(18) "Public employer" means this State or any political subdivision, or any agency or instrumentality of this State or any political subdivision, whose employees are participants in a retirement program.

(19) "Retirement program" means a program of rights and obligations which a public employer establishes or maintains and which, by its express terms or as a result of surrounding circumstances:

(A) provides retirement income to employees; or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond.

(20) "Retirement system" means an entity established or maintained by a public employer to manage one or more retirement programs, or to invest or manage the assets of one or more retirement programs. [May also list state retirement systems and statutes authorizing the formation of systems.]

(21) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(22) "Trustee" means a person who has ultimate authority to manage a retirement system or to invest or manage its assets.

Comment

The definition of "agent group of programs" in paragraph (2), together with the definitions of "appropriate grouping of programs" in paragraph (3) and "cost-sharing program" in paragraph (6), support the fiduciary requirements of Sections 8 and 9 and the reporting and disclosure requirements of Section 17. In evaluating fiduciary responsibilities and reporting obligations, the default rule is that the focus should be on each individual retirement program. A trustee, for example, should diversify the investments of each program, MPERS Act § 8(a)(2), and the annual disclosure of financial and actuarial status should identify each program. MPERS Act § 17(c)(1). Some retirement programs, however, are so interconnected that the focus appropriately should be on a grouping of programs. These definitions are used later in the Act to delineate when the default focus on individual programs is overridden and the focus should fall instead on a grouping of programs. The definitions track those established in Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, Statement of Governmental Accounting Standards No. 25, ¶¶ 15-16, 44 (Governmental Accounting Standards Board, 1994) (hereinafter "GASB Statement No. 25"), and, hence, are well understood in the actuarial community.

The phrase "other than the participant" in the definition of "beneficiary" in paragraph (4) creates a distinction between participants and beneficiaries. In essence, a participant expects benefits based on her own service, while a beneficiary expects benefits based on someone else's service. The phrase, however, does not preclude the possibility that someone can, at the same time, be both a participant based on her own service and a beneficiary based on someone else's service.

Paragraph (5) refers to the federal Internal Revenue Code of 1986. State and local retirement programs have varied and complex relationships to the Code, and the Act makes reference to it at several points. The National Conference recognizes that in some States this may give rise to problems of delegation of legislative power. However, given the complex relationship between many state laws and the Code, references of this type are increasingly common and have been sustained. *See, e.g., McFaddin v. Jackson*, 738 S.W.2d 176 (Tenn. 1987); *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969); *City National Bank of Clinton v. Iowa State Tax Commission*, 102 N.W.2d 381 (1960). In any event, whatever difficulties may be involved, the course adopted in this Act seems preferable to the alternative of restating federal tax law in the Act, continually monitoring that law for relevant changes, and repeatedly amending the Act in response to changes.

The definition of fiduciary in paragraph (11) is derived from ERISA § 3(21), 29 U.S.C. § 1002(21) (1994), and is intended to incorporate ERISA's general, discretion-sensitive conceptions of fiduciary status into the Act. The definition is important because it, along with the term trustee, specifies who may be liable under the Act. *See* MPERS Act § 11. At the same time, however, the definition of fiduciary in this Act is less important than the definition of fiduciary under ERISA because this Act, unlike ERISA, does not preempt other possible causes of action against actors who do not fit within this Act's definition of fiduciary. *See* MPERS Act § 11(a), Comment at ___. Nonfiduciaries under this Act would still be subject to actions outside this Act based on their contracts (which themselves could impose fiduciary duties); on any independent sources of fiduciary obligation; on other obligations under state law (such as agency, tort or professional responsibility law); or on federal law.

The definition of "furnish" in paragraph (12) is intended to require that information be made readily available to the intended recipient, but is not intended to limit the technology used to make the delivery. The definition is intended to be interpreted broadly to permit conveyance of information through a wide variety of modern technologies, such as by fax or electronic delivery, but only if the sender has reasonable grounds to believe that the information would reach the intended recipient through the use of those technologies. It draws on definitions in the Uniform Partnership Act, § 102(c) (1994) and the Uniform Commercial Code, § 1-201(38) (1994).

The definition of public employer in paragraph (18) tracks the definition of "governmental plan" in Section 3(32) of ERISA. 29 U.S.C. § 1002(32) (1994). *See also* I.R.C. § 414(d) (1994) (very similar definition of "governmental plan" used in the Code). ERISA is broadly preemptive of state law, but it does not cover governmental plans. ERISA §§ 4(b)(1), 514, 29 U.S.C. §§ 1003(b)(1), 1144 (1994). The Drafting Committee considered drafting language to include various types of state employers more specifically, for example, municipal corporations, home rule cities, charter cities, public school districts, and public hospital organizations. Instead, however, the Drafting Committee decided to track the ERISA language to make it clear that the definition is intended to reach all state employers that fall within ERISA's exemption for governmental plans. Thus, even though the definition does not specifically mention various types of state employers, the intent is to be broadly inclusive.

The definition of trustee in paragraph (22), by necessity, must cover a wide range of institutional arrangements for the allocation of ultimate authority over retirement systems. Some retirement systems have one set of trustees with ultimate authority over all aspects of the system. Other systems have more than one set of trustees, with each set having ultimate authority over a particular aspect of the system. The definition of trustee is intended to cover every person who has ultimate authority over any aspect of a retirement system. Later sections of the Act using the term "trustee" may refer to all trustees or to only some trustees, depending on context and the institutional arrangements of the particular retirement system. For example, as a general matter, all trustees may delegate functions under Section 6, but only trustees with authority to invest and manage retirement system assets are subject to the duties of Section 8.

The Drafting Committee decided not to include in the Act any rules for the selection or composition of boards of trustees. A principal reason for this was that the subject was outside the scope of the Committee's mission. Another reason was the considerable diversity of opinion on the Committee about whether stakeholder representation on boards was a good idea. Some thought that stakeholders (including employees, employers, participants, and beneficiaries) should be represented on governing boards, while others saw little need for such representation. Finally, many on the Committee thought the issue would be difficult to resolve in a uniform law given that States differ legitimately on a number of issues relating to board selection and composition, such as the size of trustee boards, what stakeholder groups merit representation, the proportion of representation each group should have, who is entitled to select each stakeholder's representative, etc. It should be noted, however, that the Act does not leave completely unattended the interests that fuel concern about stakeholder representation on trustee boards; regardless of how they are selected or who they represent, the Act requires trustees to act solely in the interest of participants and beneficiaries. MPERS Act, § 7(1). *See NLRB v. Amax Coal Co.*, 453 U.S. 322 (1981) (fiduciary of employee benefit trust fund owes duties to beneficiaries of fund, not to party that appointed him).

SECTION 3. SCOPE. This [Act] applies to all retirement programs and retirement systems, except:

(1) a retirement program that is unfunded and is maintained by a public employer solely for the purpose of providing deferred compensation for a select group of management employees or employees who rank in the top five percent of employees of that employer based on compensation;

(2) a severance-pay arrangement under which:

(A) payments are made solely on account of the termination of an employee's service and are not contingent upon the employee's retiring;

(B) the total amount of the payments does not exceed the equivalent of twice the employee's total earnings from the public employer during the year immediately preceding the termination of service; and

(C) all payments are completed within 24 months after the termination of service;

(3) an arrangement or payment made on behalf of an employee because the employee is covered by Title II of the Social Security Act, as amended;

(4) a qualified governmental excess benefit arrangement within the meaning of Section 415(m) of the Code;

(5) an individual retirement account or individual retirement annuity within the meaning of Section 408 of the Code;

(6) a retirement program consisting solely of annuity contracts or custodial accounts satisfying the requirements of Section 403(b) of the Code; or

(7) a program maintained solely for the purpose of complying with workers' compensation laws or disability insurance laws.

Comment

Paragraph (1) provides an exception for unfunded programs maintained by an employer for a select group of management or highly compensated employees. It tracks language in ERISA that exempts "top hat" plans from many of that Act's requirements. ERISA §§ 201(2), 301(a)(3), 401(a)(1), 4021(b)(6), 29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1), 1321(b)(6) (1994). *See also* 29 C.F.R. § 2520.104-24 (1997). The rationale for the exception is two-fold. First, a select group of management or highly compensated employees is likely to be sufficiently sophisticated and in an adequately secure position to protect its own interests, even without the protections afforded by this Act. *See* DOL ERISA Advisory Opinion 90-14A ("certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan, taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of [ERISA]"). Second, select groups by their nature are small, so the costs of compliance may well outweigh the likely benefits of coverage.

Paragraph (2) clarifies that severance pay arrangements are not subject to the Act. This Act is concerned with the special problems of retirement programs that arise, in large part, because of the long-term nature and complexity of the pension promise. Severance pay arrangements, in general, are one-time payments made pursuant to a relatively simple promise. The special protections of this Act, then, are not necessary or appropriate for severance pay arrangements. The drafters of ERISA made a similar calculation in authorizing the Secretary of Labor to exempt severance pay arrangements from that Act's definition of "pension plan." ERISA § 3(2)(B), 29 U.S.C. § 1002(2)(B) (1994). The language of paragraph (2) is based generally on the Secretary's regulation. 29 C.F.R. § 2510.3-2(b) (1997).

Paragraph (3) provides an exception for arrangements with or payments made to the federal social security system on behalf of employees who are covered by social security. Public employees may be covered by social security pursuant to a coverage agreement between their State and the Commissioner of Social Security under Section 218 of the Social Security Act, 42 U.S.C. § 418 (1994), or because the employees' public employer does not provide an adequate level of retirement benefits through a retirement program. 42 U.S.C. § 410(a)(7)(F) (1994). *See* Service by Employees Who Are Not Members of a Public Retirement System, 26 C.F.R. § 31.3121(b)(7)-2 (1997).

Paragraph (4) provides an exception for qualified governmental excess benefit arrangements. These types of arrangements were authorized by the Small Business Job Protection Act, enacted in 1996, to ease problems governmental employers were facing in complying with the benefit limitations of Section 415 of the Code. Small Business Job Protection Act, Pub. L. No. 104-188, § 1444(b)(1), 110 Stat. 1755, 1809-10 (1996) (to be codifed at I.R.C. § 415(m)). Qualified governmental excess benefit arrangements are not covered for two primary reasons. First, for tax reasons, these arrangements are likely to be either unfunded or funded through grantor trusts that are subject to the claims of the public employer's creditors. The requirements of this Act would be inconsistent with the latter approach and ill-suited for the former. Second, since these types of arrangements apply only to benefits in excess of the Section 415 limits, the class of employees affected, like the class excepted under paragraph (1), is likely to be sufficiently sophisticated and in an adequately secure position to protect its own interests, even without the protections afforded by this Act.

Paragraph (5) provides an exception for individual retirement accounts (IRAs). For most IRAs this is merely a clarification; most IRAs are established by individuals and, hence, would not be retirement programs within the definition of Section 2(19) because they are not established or maintained by a public employer. Some IRAs, however, are established or maintained by public employers. I.R.C. §§ 408(c), 408(k) (1994). This paragraph means that these types of IRAs are not governed by the Act either.

IRAs are not covered by the Act because they do not pose the special problems to which the protections of this Act are directed. IRAs require (1) the involvement of financial intermediaries (for example, banks or insurance companies) that are subject to independent sources of fiduciary obligation and (2) annual reports to employees by the organizations maintaining the accounts or annuities. 26 C.F.R. § 1.408-5 (1997). For IRAs, then, most of the protections of this Act would duplicate protections elsewhere. Thus, the costs of complying with the Act, although likely to be minimal, would not be justified. For the same reasons, paragraph (6) provides an exception for annuities or custodial accounts under I.R.C. § 403(b) (1994).

Paragraph (7) clarifies that workers' compensation and disability insurance programs are not subject to the Act even though the programs may provide retirement income to some employees and thus fit within a strict reading of the definition of retirement program in Section 2(19).

Several paragraphs in this section refer either to the federal Internal Revenue Code of 1986 or to the federal Social Security Act. The National Conference recognizes that in some States these references may give rise to problems of delegation of legislative power. However, given the complex relationship between state and federal laws, especially state law and the Internal Revenue Code, references of this type are increasingly common and have been sustained. *See, e.g.*, *McFaddin v. Jackson*, 738 S.W.2d 176 (Tenn. 1987); *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969); *City National Bank of Clinton v. Iowa State Tax Commission*, 102 N.W.2d 381 (1960). In any event, whatever difficulties may be involved, the course adopted in this Act seems preferable to the alternative of attempting to restate federal law in the Act, continually monitoring that law for relevant changes, and repeatedly amending the Act in response to changes. The references to federal law identify with precision the exceptions intended, they speak clearly and succinctly to the intended audience who are likely to be familiar with the references, and they facilitate re-enactment when required by state law to incorporate changes to federal law.

SECTION 4. ESTABLISHMENT OF TRUST.

(a) Except as otherwise provided in subsection (b), all assets of a retirement system are held in trust. The trustee has the exclusive authority, subject to this [Act], to invest and manage those assets.

(b) Assets of a retirement system which consist of insurance contracts or policies issued by an insurer, assets of an insurer, and assets of the system held by an insurer need not be held in trust.
(c) If an insurer issues a guaranteed benefit policy to a retirement system, assets of the system include the policy but not assets of the insurer.

(d) If a retirement system invests in a security issued by an investment company registered under the Investment Company Act of 1940, the assets of the system include the security but not assets of the investment company.

Comment

Subsection (a) states the basic principle of this section: All assets of a retirement system are held in trust. Subsections (b) through (d) provide guidance on particular applications of the principle.

Subsection (b) applies the general principle to insurance contracts or policies and assets controlled by insurance companies. Insurance contracts and policies themselves need not be held in trust. This means, for example, that a system purchasing annuity contracts to provide future benefits for participants could permit those contracts to be held directly by the participants, rather than in trust by the trustee. Subsection (b) also provides that neither assets of an insurance company nor assets of a system which are held by an insurance company need be held in trust. Unless the assets fit within the narrower exception in subsection (c), however, the individuals managing the assets are subject to the fiduciary duties of Section 7 (for separate accounts) or 9(d) (for general accounts). The effect of this exception in subsection (b), then, is to abrogate obligations imposed by the trust requirement only, that is, by the trust requirement but not by the fiduciary duties of this Act. In particular, the primary effect is to permit insurance companies to commingle retirement system assets with other assets.

Subsections (c) and (d) clarify application of the Act to guaranteed benefit policies issued by an insurer and to securities issued by an investment company registered under the Investment Company Act of 1940. The basic approach for both is the same. The securities and policies themselves are "assets of the system" and, hence, subject to the Act's trust and fiduciary sections, but the underlying assets with the insurer and investment company are not "assets of the system" and, hence, are not subject to the trust and fiduciary sections. This means that decisions to invest in these types of policies or securities are fiduciary decisions and that the policies or securities themselves must be placed in trust (unless they fit within the subsection (b) exception). However, once the underlying assets are with the insurer or investment company, neither the trust nor fiduciary sections of this Act apply to decisions respecting those assets.

The general principle in operation, then, is the same for both guaranteed benefit policies and investment company securities: The obligations of this Act apply to decisions to invest in these types of policies and securities, but do not flow through to decisions made by the insurance or investment company respecting the underlying assets. Although subsections (c) and (d) provide safe harbors for these two circumstances, this general principle also applies in other circumstances (for example, to publicly-offered securities held by a retirement system). Like ERISA, however, this Act does not provide a detailed listing of these circumstances or a general definition of "assets of the system." The Drafting Committee thought it inadvisable to attempt to provide a listing or definition. Applying the principle is usually quite easy, so generally a listing or definition would not be necessary or helpful. The small class of difficult cases would require a lengthy list or complex definition; that class of cases is better left to the sound discretion of trustees, within the constraints imposed by their fiduciary and disclosure obligations. The subject would be an appropriate one for rule-making. *See* 29 C.F.R. §§ 2510.3-101, 2510.3-102 (1997) (rules defining when plan investments are "plan assets" under ERISA and the I.R.C.).

The basic principle of this section - the requirement that assets of retirement systems be held in trust - is one of the guiding principles of ERISA and is required of public retirement systems by the Constitutions in a number of States. *See* ERISA § 403(a), 29 U.S.C. § 1103(a) (1994); Cal. Const. art. XVI, § 17(a); Nev. Const. art. IX, § 2; Tex. Const. art. XVI, § 67(a). This section generally follows Sections 401(b)(1)-(2) and 403(b)(1)-(2) of ERISA. 29 U.S.C. §§ 1101(b)(1)-(2), 1103(b)(1)-(2) (1994).

SECTION 5. POWERS OF TRUSTEE.

(a) In addition to other powers conferred by the governing law, a trustee has exclusive authority, consistent with the trustee's duties under this [Act], to:

(1) establish an administrative budget sufficient to perform the trustee's duties and, as appropriate and reasonable, draw upon assets of the retirement system to fund the budget;
(2) obtain by [employment or] contract the services necessary to exercise the trustee's powers and perform the trustee's duties, including actuarial, auditing, custodial, investment, and legal services; and

(3) procure and dispose of goods and property necessary to exercise the trustee's powers and perform the trustee's duties.

(b) In exercising its authority under this section, a trustee is subject to the fiduciary duties of this [Act], but not to [civil service, personnel,] procurement, or similar general laws relating to the subjects of subsection (a).

Comment

This section is intended to ensure that retirement system trustees have a level of independence sufficient to permit them to perform their duties and to do so effectively and efficiently. Trustees are different from other state actors because they are subject to an extensive and stringent set of fiduciary obligations to retirement system participants and beneficiaries. These obligations both require and justify some level of trustee independence.

Independence is required because it permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging (and possibly conflicting) set of interests. In this sense, the independence of this section is an important corollary of the fiduciary obligations of other sections of this Act.

The fiduciary obligations of trustees also justify the level of independence protected by this section. Trustees are not independent without constraint; instead, they must comply with their fiduciary obligations when exercising judgment. This section provides trustees with more independence than many other state actors, but in exercising that independence the trustees are subject to a more extensive and stringent set of fiduciary obligations than other state actors.

The trustee independence protected by this section aligns well with the interests and prerogatives of the Legislature. First, the Legislature has a strong interest in effective and efficient management of public retirement systems. Mismanagement presents obvious political hazards and, in the long run, may result in lower benefits, higher contribution levels, or both. The trustee is already under a fiduciary duty to act effectively and efficiently; this section removes constraints that may interfere with the fulfillment of that duty. Second, the Legislature is interested in protecting its legitimate prerogatives. Subject to the state constitution and other law, the Legislature retains control over settlor functions; the Legislature, for example, creates retirement programs, establishes benefit levels, and determines funding methods. *Cf. Lockheed Corp. v. Spink*, 116 S. Ct. 1783 (1996) (employer did not violate fiduciary duties of ERISA by exercising settlor function to amend pension plan); *Haberern v. Kaupp Vascular Surgeons Ltd. Defined Benefit Pension Plan*, 24 F.3d 1491 (3d Cir. 1994), *cert. denied*, 513 U.S. 1149 (1995) (employer did not violate fiduciary duties of ERISA by exercising settlor functions of setting wages, creating defined benefit plan, or amending plan). *See generally*, Laurence B. Wohl, *Fiduciary Duties Under ERISA: A Tale of Multiple Loyalties*, 20 U. Dayton L. Rev. 1, 60-75 (1994) (discussing the distinction between settlor and fiduciary functions under ERISA). This section does not infringe on those prerogatives. Rather, it protects trustee independence only within the trustee's legitimate role of managing the operation, administration, and assets of a retirement system.

Subsection (a)(1) authorizes the trustee to draw upon retirement system assets to fund the administrative budget, but does not require the trustee to do so. Similarly, the paragraph does not obligate, or preclude, the State from providing revenues to fund the administrative budget. Thus, if the administrative budget is fully funded out of general state revenues, that could continue. On the other hand, if general state revenues are insufficient to fund an adequate administrative budget, the trustee has authority to supplement the revenues with retirement system assets. Similarly, if state revenues are encumbered in unacceptable ways or are inadequate for other reasons, this section ensures that the trustee has authority, within the confines of its fiduciary duties, to draw on retirement system assets to accomplish the purposes of the trust.

Subsection (a)(2) is intended to provide the trustee with broad authority over personnel matters. The intent is to free the trustee from restrictive civil service requirements; to shield the trustee against interference by others who do not share the trustee's fiduciary obligations; and to protect the trustee against representation by those with potentially conflicting interests. *Cf. People ex rel. Sklodowski v. Illinois*, 642 N.E.2d 1180 (Ill. 1994) (state attorney general not disqualified from representing three state retirement systems as defendants in a lawsuit, while also representing the State and various state officials as defendants in the same lawsuit); *Board of Trustees of the Teacher's Pension & Annuity Fund v. Verniero*, No. MER-L5119-96 (N.J. Super. Ct. Law Div., Mercer Co. filed Jan. 6, 1997) (lawsuit filed by board of public pension fund to disqualify attorney general's office from representing it in lawsuit challenging decisions to reduce state payments to fund).

The employment language is bracketed because some state constitutions may require certain retirement system employees to be within the civil service system. *See* Colo. Const. art. 12, § 13; La. Const. art. 10, § 1. In the absence of such a constitutional restriction, however, the Drafting Committee's recommendation is to include the bracketed language in the Act.

Subsection (a)(2) merely authorizes the trustee to obtain actuarial services free from interference. The paragraph does not address the effect of determinations by the trustee's actuary, nor require that the actuary obtained by the trustee under this paragraph be the only one. Those issues are decided elsewhere in state law. *Compare Dadisman v. Moore*, 384 S.E.2d 816 (W. Va. 1988) (state statutes and constitution violated when legislature failed to contribute amount to state pension funds determined appropriate by trustee's actuary) *with Jones v. Board of Trustees*, 910 S.W.2d 710 (Ky. 1995) (state statutes and constitution not violated when legislature failed to increase contribution rate recommended by trustee's actuary). *See* N.J. Rev. Stat. § 43:4B-1 (Supp. 1997) (committee designated to select an actuary for state retirement systems).

Subsection (a)(3) is intended to provide the trustee with broad authority over procurement matters. Under this subsection, trustee decisions on procurement matters must comply with the fiduciary sections of this Act, rather than with the requirements of state procurement laws.

Subsection (a) is not intended to be the sole, or even the primary, source of trustee powers. State and local laws establishing or authorizing the creation of a retirement system will remain the primary source. It is to those laws, and others governing the system or regulating its transactions, that one must look for a broader statement of trustee powers and for protections provided to third parties dealing with trustees and fiduciaries. *Cf.* Peter T. Wendel, *Examining the Mystery Behind the Unusually and Inexplicably Broad Provisions of Section Seven of the Uniform Trustees' Powers Act: A Call for Clarification*, 56 Mo. L. Rev. 25 (1991) (discussing protections provided to third parties dealing with trustees). The general powers of retirement system trustees and the protection of third parties dealing with trustees are important issues, but ones outside the scope of this Act.

Subsection (b) clarifies that the intent of the section is to subject the trustee to the fiduciary duties of this Act, but not to obligations imposed by general civil service, personnel, or procurement laws of a State or political subdivision. The subsection also clarifies that general laws that do not relate to the subjects of subsection (a), such as conflict of interest or code of ethics rules, are not affected by the section and, hence, continue to apply to the trustee. *See* Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (citing conflict of interest and code of ethics laws applicable to trustees in most States).

SECTION 6. DELEGATION OF FUNCTIONS.

(a) A trustee or administrator may delegate functions that a prudent trustee or administrator acting in a like capacity and familiar with those matters could properly delegate under the circumstances.

(b) The trustee or administrator shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the retirement program; and

(3) periodically reviewing the agent's performance and compliance with the terms of the delegation.

(c) In performing a delegated function, an agent owes a duty to the retirement system and to its participants and beneficiaries to comply with the terms of the delegation and, if a fiduciary, to comply with the duties imposed by Section 7.

(d) A trustee or administrator who complies with subsections (a) and (b) is not liable to the retirement system or to its participants or beneficiaries for the decisions or actions of the agent to whom the function was delegated.

(e) By accepting the delegation of a function from the trustee or administrator, an agent submits to the jurisdiction of the courts of this State.

(f) A trustee may limit the authority of an administrator to delegate functions under this section.

Comment

This section follows the modern trend permitting prudent delegation. The traditional rule from the law of trusts prohibited delegation by trustees of all discretionary investment and management functions. That rule survived into the 1959 Restatement of Trusts, but the trend of subsequent legislation has been to permit delegation. Restatement (Second) of Trusts § 171 (1959) (hereinafter "Restatement of Trusts 2d"). *See* John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 Mo. L. Rev. 105 (1994). The trend culminated in a reversal of the traditional rule in the third Restatement of Trusts. Restatement (Third) of Trusts: Prudent Investor Rule § 171. The new rule permitting delegation was incorporated into Section 9 of the Uniform Law Commission's Uniform Prudent Investor Act, which this section follows closely.

ERISA generally follows the modern trend on delegation, but nevertheless is more restrictive than this Act. ERISA permits broad delegation of authority over responsibilities other than the management or control of plan assets. ERISA §§ 405(c)(1), (2), 29 U.S.C. § 1105(c)(1) (1994). Authority to manage or control plan assets can also be delegated, but only to allocate responsibilities either among trustees or to "investment managers," a restrictively-defined type of agent. ERISA §§ 3(38), 402(c)(3), 403(a)(2), 405(b)(1)(B), 405(c), 405(d), 29 U.S.C. §§ 1002(38), 1102(c)(3), 1103(a)(2), 1104(b)(1)(B), 1104(c), 1104(d) (1994); 29 C.F.R. § 2509.75-8 (1997). This Act is more permissive than ERISA because it would permit broader delegations of authority to manage or control retirement system assets; under this Act, such delegations may be made to persons other than trustees or investment managers.

An intrinsic tension exists between granting trustees and administrators broad powers that facilitate flexible and efficient administration, on the one hand, and protecting beneficiaries from the misuse of such powers, on the other hand. A broad set of powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform Trustees' Powers Act (1964), permits the trustee or administrator to act vigorously and expeditiously to maximize the interests of the beneficiaries in a variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee and administrator delegate effectively, the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the trustee or administrator to delegate. But if the trustee or administrator delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.

Section 6 is designed to strike the appropriate balance between the advantages and the hazards of delegation. Section 6 authorizes delegation under the limitations of subsections (a) and (b). Subsection (a) imposes limits on the matters that can be delegated. Only functions that prudent trustees and administrators would delegate can be delegated. As a result, subsection (a) would generally not permit the trustees to delegate their obligation to adopt a statement of investment objectives and policies under Section 8(a), since prudent trustees would seldom delegate that function. At the same time, delegating the function of drafting and recommending such a statement would generally be appropriate.

Subsection (b) imposes duties of care, skill, and caution on the trustee and administrator in selecting the agent, in establishing the terms of the delegation, and in reviewing the agent's compliance. The trustee and administrator's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's participants and beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal and state legislation restricting exculpation clauses. *See* ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D), 1110(a) (1994); New York Est. Powers & Trusts Law § 11-1.7(a)(1) (McKinney 1967).

Although subsection (d) exonerates the trustee or administrator from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection (a) and (b), subsection (c) makes the agent responsible to the retirement system and to participants and beneficiaries. Moreover, as noted in the Comments to Sections 2(11) and 11(a), the agent, whether or not a fiduciary under this Act, may be subject to liability elsewhere based on fiduciary or other obligations imposed by contract or by state or federal law.

The duty to incur only appropriate and reasonable costs articulated in Sections 7(2) and (5) of this Act apply to delegation as well as to other aspects of fiduciary decision-making. In deciding whether to delegate, the trustee or administrator must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee or administrator must take costs into account. The trustee or administrator must be alert to protect participants and beneficiaries from "double dipping." If, for example, the trustee has traditionally handled the investment management function in-house, it should ordinarily follow, other things being equal, that the trustee will lower its internal expenses when delegating the investment function to an outside manager. The precise amount of the reduction would depend on factors such as the costs of monitoring and the relative efficiency of the internal and external managers, but generally trustees should be able to reduce internal expenses through delegation.

Subsection (e) requires an agent to submit to the jurisdiction of the courts of a State. The section is not intended to limit other types of agreements that might be made on similar issues. The section is not intended, for example, to preclude a choice-of-law or venue provision in an agreement between a trustee or administrator and an agent.

SECTION 7. GENERAL FIDUCIARY DUTIES. A trustee or other fiduciary shall discharge duties with respect to a retirement system:

(1) solely in the interest of the participants and beneficiaries;

(2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;

(3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;

(4) impartially, taking into account any differing interests of participants and beneficiaries;

(5) incurring only costs that are appropriate and reasonable; and

(6) in accordance with a good-faith interpretation of the law governing the retirement program and system.

Comment

This section establishes the general duties of all trustees and other fiduciaries. The duties derive from trust law and, consequently, draw upon recent articulations of that law. Restatement of the Law of Trusts 3d: Prudent Investor Rule; Uniform Prudent Investor Act. The duties also draw upon federal and state pension law. With only slight variations, ERISA and every state pension law impose these duties on retirement system fiduciaries. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994); Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (surveying the fiduciary standards in state pension law).

Paragraph (1) articulates the well-recognized trust duty of loyalty. In exercising discretion, a fiduciary must act exclusively for the participants and beneficiaries, as opposed to acting for the fiduciary's own interest or that of third parties. The duty is not limited to settings entailing self-dealing or conflict of interest in which the fiduciary would benefit personally. A fiduciary is under a duty to participants and beneficiaries "not to be influenced by the interest of any third person." Restatement of Trusts 3d: Prudent Investor Rule § 170, comment q, at 201. Thus, it is as improper for a fiduciary to take actions for the purpose of benefiting a third person as it is for a fiduciary to act in its own interest. In the retirement system setting, it is important to note that this duty includes the obligation to set aside the interests of the party that appoints a trustee or fiduciary. A trustee, for example, must act solely in the interests of participants and beneficiaries and set aside any interests of a party responsible for the trustee's appointment, such as an employer or union. *See NLRB v. Amax Coal Co.*, 453 U.S. 322 (1981); *City of Sacramento v. Public Employees Retirement Sys.*, 280 Cal. Rptr. 847 (Cal. Ct. App. 1991). The duty of loyalty is central to every statement of fiduciary duties. Restatement of Trusts 3d: Prudent Investor Rule § 170; Uniform Prudent Investor Act § 5; ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994).

Paragraph (2) specifies the fiduciary's purposes: To provide benefits to participants and beneficiaries and to pay reasonable expenses. Specification of purpose is important because the duty of loyalty precludes a fiduciary from being influenced "by motives other than the accomplishment of the purposes of the trust." Restatement of Trusts 3d: Prudent Investor Rule § 170, comment q, at 201. Paragraph (2), then, requires fiduciaries to be motivated only by the objective of providing benefits and paying reasonable expenses.

Paragraph (3) imposes another well-recognized fiduciary obligation, the obligation to act prudently. The prudence standard for trust investing dates back to *Harvard College v. Amory*, 26 Mass. (Pick.) 446 (1830), and has been an important part of virtually every subsequent codification effort. *See* Mayo A. Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century*, 12 Ohio St. L.J. 491 (1951) (discussing the Model Prudent Man Rule Statute of 1942, which codified the *Amory* rule, and its adoption in several States); Restatement of Trusts 2d § 227 (1959); Uniform Probate Code § 7-302 (1969); Restatement of Trusts 3d: Prudent Investor Rule § 227; ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994).

The concept of prudence is essentially relational or comparative. In this respect, it resembles the "reasonable person" rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective.

Paragraph (3), in applying this objective standard, requires comparison to a prudent person "acting in a like capacity and familiar with those matters." This language comes from ERISA and stakes out a middle ground. On the one hand, it is not intended to impose a rigid "prudent expert" rule. Retirement systems differ on a wide variety of parameters and the prudence standard is sensitive to factors such as the size, complexity, and purpose of each system. Fiduciaries should be evaluated, not against a single prudent expert, but in terms of the actions of prudent fiduciaries for other similar systems facing similar circumstances. At the same time, paragraph (3) does not permit comparison to a prudent amateur. Fiduciaries will be held to no lower standard than that of others "familiar with those matters." *See Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980) ("While there is flexibility in the prudence standard, it is not a refuge for fiduciaries who are not equipped to evaluate a complex investment"); *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir.), *cert. denied*, 469 U.S. 1072 (1984) ("A trustee's lack of familiarity with investments is no excuse: ... trustees are to be judged 'according to the standards of others "acting in a like capacity and familiar with such matters"'"). This contrasts with conventional private trusts, where the law anticipates amateur trusteeship and allows comparison to the standards of a prudent amateur. Uniform Prudent Investor Act § 2, Comment at 21.

The articulation of the prudence standard in paragraph (3) differs slightly from the articulation in ERISA, which has been followed in many state statutes. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994) (fiduciary must act "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"). *See* Idaho Code § 59-1301(2)(b) (1994); Ohio Rev. Code Ann. § 145.11(B) (Anderson Supp. 1996). The differences are not intended to change the prudence standard substantively. Instead, the differences merely reflect style changes and efforts to align articulation of the obligation in this Act with that of the Prudent Investor Act.

The duty of impartiality in paragraph (4) derives from the duty of loyalty. A fiduciary for a retirement system owes a duty of loyalty to all participants and beneficiaries; respecting that duty requires the fiduciary to be impartial among any differing interests of participants and beneficiaries. The duty is well-recognized in trust law. Restatement of Trusts 2d §§ 183, 232; Uniform Prudent Investor Act § 6.

Differing interests are inevitable in the retirement system setting. Differences can arise between retirees and working members, young members and old, long- and short-term employees, and other groupings of those with interests in the retirement system. The duty of impartiality does not mean that fiduciaries must accommodate such interests according to some notion of absolute equality. The duty of impartiality permits a fiduciary to favor the interests of one group of participants and beneficiaries over another in particular circumstances, but requires that such decisions be made carefully and after weighing the differing interests. *See Ganton Techs., Inc. v. National Indus. Group Pension Plan*, 76 F.3d 462 (2d Cir. 1996) (no fiduciary violation to prohibit transfer of funds when employees exit from multi-employer plan, even though rule treats exiting members less favorably than members remaining in plan); *Mahoney v. Board of Trustees*, 973 F.2d 968 (1st Cir. 1992) (no fiduciary violation to grant benefit increase favoring working longshoremen over retirees); *DeCarlo v. Rochester Carpenters Pension, Annuity, Welfare & S.U.B. Funds*, 823 F. Supp. 115 (W.D.N.Y. 1993) (no fiduciary violation to grant benefit increase favoring active participants over retirees). *See also* Restatement of Trusts 2d § 232 (impartiality requires trustee for successive beneficiaries to act "with due regard" for their respective interests).

Paragraph (5) incorporates the traditional duty to incur only expenses that are appropriate and reasonable. Wasting the money of participants and beneficiaries is imprudent. This duty is present in every statement of fiduciary duties. Restatement of Trusts 2d § 188; Uniform Prudent Investor Act § 7; ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (1994). As under the Restatement of Trusts and the Uniform Prudent Investor Act, determining what costs are appropriate and reasonable will depend on factors such as the purposes of the trust (which for retirement systems covered by this Act are specified in paragraph (2)), the types of assets held, and the skills of the trustee or other fiduciary. On this last factor, for example, trustees who are quite inexperienced on investment issues may be justified in expending more for investment advice than trustees who are quite experienced.

Paragraph (6) requires trustees and other fiduciaries to discharge their duties in accordance with a good-faith interpretation of the law. Fiduciaries are expected to exercise prudence in determining what the law requires and to comply with the law to the best of their abilities, but the good-faith element recognizes that they are not expected to be infallible predictors. A fiduciary who discharges her duties prudently and with a good-faith belief that her actions are in compliance with the law does not violate this paragraph, even if a court later determines that the course of conduct was not in compliance with law. *See Wisconsin Retired Teachers Ass'n v. Employee Trust Funds Bd.*, 558 N.W.2d 83 (Wis. 1997) (trustees did not violate fiduciary duties when they implemented a law relying in good faith on legal advice, even though law was later found to be unconstitutional). Not all failures to comply with the law are fiduciary violations, but only those that do not reflect a good-faith attempt to comply. Viewed properly in this way, the good-faith requirement reinforces Section 10(1) of this Act, which requires that compliance with fiduciary obligations be determined at the time of the trustee or fiduciary's action, and not by hindsight.

Sections 7 and 8 follow trust and pension law in imposing general affirmative duties upon fiduciaries. Fiduciaries, for example, must diversify investments and act loyally, prudently, and impartially. As applied to non-governmental plans, federal pension law also imposes negative duties upon fiduciaries. Fiduciaries may not engage in specified types of "prohibited transactions." ERISA §§ 406-408, 29 U.S.C. §§ 1106-1108 (1994); I.R.C. § 4975 (1994). For several reasons, this Act does not contain an equivalent set of negative duties. First, the prohibited transaction provisions in federal law have necessitated an extremely complex set of statutory exemptions and administrative waivers. For a brief review, see Michael J. Canan, Qualified Retirement and Other Employee Benefit Plans § 16.7 (1996) (listing 27 class exemptions granting broad administrative waivers and 5 categories of statutory exemptions). The Drafting Committee was reluctant to duplicate that complexity in every adopting State. Second, the negative duties would add little to the affirmative fiduciary duties of the Act. Properly applied, the fiduciary standards already guard against all the more specific hazards that would be targeted by prohibited transactions rules. Third, the negative duties would tend to duplicate protections elsewhere in state law. Most States have conflict of interest and code of ethics rules that apply to a broad range of government employees and officials (and, hence, would not be repealed when this Act is enacted) and that prohibit some of the same conduct targeted by the prohibited transactions rules. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (citing the conflict of interest and code of ethics rules in each State). Finally, this Act requires disclosure of transactions between the retirement system and significant actors. *See* MPERS Act §§ 16(12) and (13). Disclosure will subject such transactions to public scrutiny, including possible claims of fiduciary violations and, hence, should discourage many of the same activities forbidden by the prohibited transaction rules. *See* ERISA §§ 3(14), 406(a), 29 U.S.C. §§ 1002(14), 1106(a) (1994) (limiting transactions between a pension plan and a party in interest).

For similar reasons, this Act does not follow ERISA in providing a special set of rules that apply to co-fiduciary liability. ERISA § 405, 29 U.S.C. § 1105 (1994). Properly applied, the general fiduciary standards in this Act already impose the duties specified in more detail in ERISA's Section 405. For example, a fiduciary who knowingly participates in another fiduciary's breach would already be in breach of her duties under Section 7 of this Act. Restating that liability more specifically in another section of the Act would serve little purpose.

SECTION 8. DUTIES OF TRUSTEE IN INVESTING AND MANAGING ASSETS OF RETIREMENT SYSTEM.

(a) In investing and managing assets of a retirement system pursuant to Section 7, a trustee with authority to invest and manage assets:

(1) shall consider among other circumstances:

(A) general economic conditions;

(B) the possible effect of inflation or deflation;

(C) the role that each investment or course of action plays within the overall portfolio of the retirement program or appropriate grouping of programs;

(D) the expected total return from income and the appreciation of capital;

(E) needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(F) for defined benefit plans, the adequacy of funding for the plan based on reasonable actuarial factors;

(2) shall diversify the investments of each retirement program or appropriate grouping of programs unless the trustee reasonably determines that, because of special circumstances, it is clearly prudent not to do so;

(3) shall make a reasonable effort to verify facts relevant to the investment and management of assets of a retirement system;

(4) may invest in any kind of property or type of investment consistent with this [Act]; and

(5) may consider benefits created by an investment in addition to investment return only if the trustee determines that the investment providing these collateral benefits would be prudent even without the collateral benefits.

(b) A trustee with authority to invest and manage assets of a retirement system shall adopt a statement of investment objectives and policies for each retirement program or appropriate grouping of programs. The statement must include the desired rate of return on assets overall, the desired rates of return and acceptable levels of risk for each asset class, asset-allocation goals, guidelines for the delegation of authority, and information on the types of reports to be used to evaluate investment performance. At least annually, the trustee shall review the statement and change or reaffirm it.

Comment

This section specifies the fiduciary duties of trustees who have the ultimate responsibility for the investment and management of retirement system assets. Since a trustee covered by this section is also a fiduciary under the Act, MPERS Act § 2(11), these duties supplement the general duties of Section 7.

This section applies only to a trustee with authority to invest and manage retirement system assets. The "trustee" requirement means that only those with "ultimate authority" to invest and manage system assets are covered. *See* MPERS Act § 2(22) (defining "trustee"). Delegates who invest and manage system assets are covered by Sections 6 and 7, but not this section. The "invests and manages" requirement means that only a trustee with those responsibilities is covered. A trustee who does not have authority to invest or manage system assets is contemplated by the Act, but is not covered by this section. *See* MPERS Act § 2(22), Comment at ___.

Subsection (a)(1) provides a non-exclusive list of factors that commonly bear on risk/return preferences in retirement system investing, and requires trustees to consider them in making investment and management decisions. Read in conjunction with Section 10(2), this subsection sounds the main theme of modern investment practice, sensitivity to the risk/return curve. Subsection (a)(1) tracks appropriate language from Section 2(c) of the Uniform Prudent Investor Act.

Subsection (a)(2) integrates a diversification requirement into the concept of prudent investing. Once again, this follows the lead of the Restatement of Trusts 3d and the Uniform Prudent Investor Act. Restatement of Trusts 3d: Prudent Investor Rule § 227(b); Uniform Prudent Investor Act § 3. ERISA also contains a diversification requirement. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1994).

Modern portfolio theory strongly supports a diversification requirement. Modern theory divides risk into the categories of "compensated" and "uncompensated" risk. The risk of owning shares in a mature and well-managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. A higher expected return is required to induce an investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk - the firm pays investors for bearing the risk. By contrast, nobody pays an investor for owning too few stocks. An investor who owned only international oil stocks in 1973 (immediately before the Arab oil embargo) was running a risk that could have been reduced by configuring the portfolio differently - to include investments in different industries. Risk that can be reduced by adding different stocks (or bonds) is uncompensated risk - nobody pays the investor for owning shares in two few industries and too few companies. The object of diversification is to minimize this uncompensated risk: "As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the separate holdings." R.A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983).
This Act does not contain a simple and easy-to-apply rule for identifying how much diversification is enough, because one does not exist:

There is no defined set of asset categories to be considered by fiduciary investors. Nor does a trustee's general duty to diversify investments assume that all basic categories are to be represented in a trust's portfolio. In fact, given the variety of defensible investment strategies and the wide variations in trust purposes, terms, obligations, and other circumstances, diversification concerns do not necessarily preclude an asset allocation plan that emphasizes a single category of investments as long as the requirements of both caution and impartiality are accommodated in a manner suitable to the objectives of the particular trust. . . .

Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries and having other differences in their qualities. Broader diversification, however, is usually to be preferred in trust investing.

Restatement of Trusts 3d: Prudent Investor Rule § 227, comment g, at 26-27. *See also* Jonathan R. Macey, An Introduction to Modern Financial Theory 23-24 (American College of Trust and Estate Counsel Foundation, 1991); R.A. Brealey, *supra*, at 111-13. *Cf.* Richard H. Koppes & Maureen L. Reilly, *An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor An Index*, 20 J. Corp. L. 413, 445-47 (1995) (cautioning against overdiversification which can occur because of the cost of monitoring investments).

Subsection (a)(2), like the authorities from which it is drawn, contains a limited exception to the diversification requirement. Restatement of Trusts 3d: Prudent Investor Rule § 227(b) (duty to diversify "unless, under the circumstances, it is prudent not to do so"); Uniform Prudent Investor Act § 3 (duty to diversify "unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying"); ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1994) (duty to diversify "unless under the circumstances it is clearly prudent not to do so"). For private trusts, a number of circumstances might exist which would legitimately justify underdiversification. The Uniform Prudent Investor Act, for example, lists tax considerations and the interest in retaining a family business as such circumstances. Section 3, Comment at 11. *See also* Restatement of Trusts 3d: Prudent Investor Rule § 227, comment at 25. The circumstances justifying underdiversification are less likely to be present for public pension trusts. As a result, only very rarely, if ever, will it be prudent for the trustee of a public pension fund to underdiversify.

Subsection (a)(3) incorporates the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or security of an investment, for example, audit reports or records of title. *E.g.*, *Estate of Collins*, 139 Cal. Rptr. 644 (Cal. Ct. App. 1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have land appraised, and accepted an unaudited financial statement; held liable for losses). This subsection follows Section 2(d) of the Uniform Prudent Investor Act. In this subsection, and elsewhere, "management" embraces monitoring, that is, the trustee's continuing responsibility for oversight of the suitability of investments already made, as well as the trustee's decisions respecting new investments.

In the absence of statutory language elsewhere, subsection (a)(4) abrogates categoric restrictions on investments. No particular kind of property or investment is inherently imprudent. The universe of investment products changes incessantly. Investments that were once thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility - in this case, inflation risk - that had not been anticipated. Under subsection (a)(4), the propriety of including an investment in a retirement system portfolio must be judged, not on the basis of a categoric restriction, but instead in terms of its anticipated effect on the particular system's portfolio. The premise of the subsection is that participants and beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives, as prescribed in subsection (a)(1) and Section 10(2), than in attempts to identify categories of investment that are prudent or imprudent *per se*. In this respect, subsection (a)(4) follows the lead of the Restatement of Trusts 3d and the Prudent Investor Act. Restatement of Trusts 3d: Prudent Investor Rule § 227, comment f, at 24; Uniform Prudent Investor Act § 2(e), Comment, at 21.

More than half the States currently have statutes that impose some type of categoric restriction on investments. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money 99-100 (3d ed. 1995). These are commonly known as "legal list" statutes. The Drafting Committee suggests that those statutes be repealed when this Act is enacted. To the extent they are not repealed, subsection (a)(4) must be read in conjunction with Section 7(6), which requires fiduciaries to act in accordance with a good-faith interpretation of the law governing the retirement program and system. Thus, compliance with legal list statutes would be required because the standards of the Act require compliance; subsection (a)(4) would apply only to investments that are not inconsistent with existent legal list restrictions.

Subsection (a)(5) deals with the issue of collateral benefits. Collateral benefits refer to benefits other than investment return. Investments raising collateral benefits issues come in a variety of forms, including investments that involve moral or political issues (such as investments in South Africa or Northern Ireland), investments targeted to improve the general economic well-being of a State or region, and investments intended to protect or enhance the job prospects of pension plan participants. Retirement systems subject to this Act invest significant sums in investments that produce collateral benefits and, undoubtedly, refrain from investing another significant (but undeterminable) amount in investments that are disfavored. U.S. General Accounting Office, Public Pension Plans: Evaluation of Economically Targeted Investment Programs 2 (March, 1995) (in a 1992 survey, 50 of the largest public pension systems had invested $19.8 billion, or 2.4 percent of assets, in economically targeted investments); James A. White, *Divestment Proves Costly and Hard*, Wall St. J., Feb. 22, 1989 (New Jersey public plan required to divest $4.2 billion of assets under statute prohibiting South African investments). There is a large literature on the subject. *See* Maria O'Brien Hylton, *"Socially Responsible" Investment: Doing Good Versus Doing Well in an Inefficient Market*, 42 Am. U. L. Rev. 1 (1992); Joel C. Dobris, *Arguments in Favor of Fiduciary Divestment of "South African" Securities*, 65 Neb. L. Rev. 209 (1986); John H. Langbein, *Social Investing of Pension Funds and University Endowments: Unprincipled, Futile, and Illegal, in* Disinvestment, Is it Legal? Is it Moral? Is it Productive?: An Analysis of Politicizing Investment Decisions (John H. Langbein et al. eds., 1985); James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 U. Pa. L. Rev. 1340 (1980); John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts,* 79 Mich. L. Rev. 72 (1980).

Subsection (a)(5) follows the basic approach of the Department of Labor's Interpretive Bulletin on economically targeted investments. 29 CFR § 2509.94-1 (1996). Arrangements designed to bring areas of investment opportunity which provide collateral benefits to the attention of the trustee will not by themselves constitute a fiduciary violation, so long as the arrangements do not restrict the exercise of the trustee's investment discretion. Similarly, the trustee does not violate any fiduciary responsibilities by making a decision based on collateral benefits *if* the investment is justified even absent the collateral benefits. Thus, as under the Labor Department's interpretive bulletin, an investment would be appropriate under this subsection if it is expected to provide an investment return commensurate with available alternative investments having similar risks. On the other hand, an investment will not be prudent if it is expected to produce a lower expected rate of return than available alternative investments with commensurate risk, or if it is riskier than available alternative investments with commensurate rates of return.

A number of States currently have statutes that relate to investments producing collateral benefits. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money viii-ix (3d ed. 1995) (listing 22 States with statutory language on economically targeted investments and 10 States with language limiting investments in South Africa, Northern Ireland, Cuba, or companies complying with the Arab League's boycott of Israel). The Drafting Committee suggests that these statutes be repealed when this Act is enacted. To the extent they are not repealed, they must be read in conjunction with subsection (a)(5). To the extent the statutes are not mandatory, the trustee must exercise the discretion permitted by the statutes within the constraints of subsection (a)(5). *See* Minn. Stat. § 11A.241 (1988) (state board of investment directed to encourage affirmative action by companies operating in Northern Ireland). To the extent the statutes are mandatory, the trustee must comply with them and subsection (a)(5) would apply only in other areas where the trustee retains investment discretion. *See* Fla. Stat. ch. 215.471, 215.472 (Supp. 1995) (requiring divestiture of and prohibiting investments in companies dealing with Cuba).

Subsection (b) requires the trustee to adopt a statement of investment objectives and policies. The statement must include various estimates of desired rates of return; these estimates, obviously, are intended to reflect long-range expectations and are not intended as specific predictions of actual, short-term returns. Section 17(c)(7) requires the statement to be included in the annual disclosure of financial and actuarial status. A number of States already have statutes requiring their trustees to adopt such a statement. *See* Ark. Code Ann. § 24-3-410(a)(2)(A) (1996); N.D. Cent. Code § 21-10-02.1 (Supp. 1995); Or. Rev. Stat. § 293.731 (1995); W. Va. Code § 12-6-12 (Supp. 1996). The requirement is also consistent with the fiduciary duties of ERISA. 29 C.F.R. § 2509.94-2(2) (1997). The Act lists certain information that must be included in the statement, but the list is not exclusive. Where appropriate, a trustee may include other information in the statement, such as guidelines for proxy voting decisions.

SECTION 9. SPECIAL APPLICATION OF DUTIES.

(a) A trustee may return a contribution [with interest] to a public employer or employee, or make alternative arrangements for reimbursement, if the trustee determines the contribution was made because of a mistake of fact or law.

(b) Upon termination of a retirement program, a trustee may return to a public employer any assets of the program remaining after all liabilities of the program to participants and beneficiaries have been satisfied.

(c) If a retirement program provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in such an account and a participant or beneficiary exercises control over those assets:

(1) the participant or beneficiary is not a fiduciary by reason of the exercise of control; and

(2) a person who is otherwise a fiduciary is not liable for any loss, or by reason of any breach of fiduciary duty, resulting from the participant's or beneficiary's exercise of control.

(d) If an insurer issues to a retirement system a contract or policy that is supported by the insurer's general account but is not a guaranteed benefit policy, the insurer complies with Section 7 if it manages the assets of the general account with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose, taking into account all obligations supported by the general account.

Comment

Subsection (a) is based on ERISA § 403(c)(2), 29 U.S.C. § 1103(c)(2) (1994). The subsection clarifies that a trustee does not violate the Act's fiduciary obligations by returning mistaken contributions or by making alternative arrangements for reimbursement (such as a setoff against future contributions). Following ERISA, the subsection is permissive. It permits, but does not require, a trustee to return mistaken contributions; a suit seeking to require a trustee to return contributions must be based elsewhere in plan documents or the law. *See Brown v. Health Care & Retirement Corp.*, 25 F.3d 90 (2d Cir. 1994) (ERISA does not entitle employer to offset for mistaken contributions, but plan is permitted to offset in accordance with its own policy); *UIU Severance Pay Trust Fund v. Local Union No. 18-U*, 998 F.2d 509 (7th Cir. 1993) (ERISA permits but does not require return of mistaken contributions; union can seek to recover contributions through common law action for restitution). Subsection (a) has bracketed language permitting interest to be paid on a returned contribution. This Act takes no position on that issue. If a State wants to permit interest to be paid, it should include the language in the Act; if not, it should not include the language. *See Whitworth Bros. Storage Co. v. Central States, Southeast & Southwest Areas Pension Fund*, 982 F.2d 1006 (6th

Cir.), *cert. denied*, 479 U.S. 1007 (1986) (ERISA bars an award of interest on returned contributions). *See also Stanley v. Retirement & Health Benefits Div.*, 310 S.E.2d 637 (N.C. Ct. App.), *review denied*, 315 S.E.2d 692 (N.C. 1984) (retirement system not required to pay interest under state law).

Subsection (b) provides a narrow exception to the loyalty and exclusive purpose obligations of Section 7(1) and 7(2) in the event a retirement program is terminated. As with subsection (a), this subsection is merely permissive; it provides only that a trustee does not violate its fiduciary obligations if excess assets are paid to employers after termination and after all liabilities to participants and beneficiaries have been satisfied. Any action attempting to require a trustee to return excess assets to a public employer must be based elsewhere in state law. Similarly, the subsection does not in any way preclude or prejudice the return of excess benefits to participants and beneficiaries; that possibility is not mentioned in this subsection only because returning excess assets to participants and beneficiaries would not require an exception to the normal fiduciary obligations of Section 7. Terminations raise a host of other issues that are beyond the scope of this Act and, hence, are left to other law. *See generally* Michael J. Canan, Qualified Retirement and Other Employee Benefit Plans §§ 20.1-20.7 (1996); Jeffrey D. Mamorsky, Employee Benefits Law: ERISA and Beyond §§ 9.01-9.03, 13.01-13.09 (1995).

Subsection (c) provides two exceptions to the fiduciary rules for retirement programs providing participant-directed individual accounts: (1) a participant who exercises control over assets in an individual account is not a fiduciary under this Act by reason of the exercise, and (2) a person who is otherwise a fiduciary is not liable under the fiduciary sections for any losses that result from the participant's exercise of control. In the absence of this subsection, retirement programs would be reluctant to offer participant-directed accounts for two reasons: First, because participants exercising control would be fiduciaries and, hence, potentially liable to subsequent beneficiaries for failure to comply with the fiduciary standards (for example, for failing to adequately diversify) and, second, because the programs' non-participant fiduciaries may also be liable for investment decisions made by participants.

Subsection (c) derives from ERISA § 404(c), 29 U.S.C. § 1104(c) (1994). The Department of Labor has issued regulations to clarify application of § 404(c). While those regulations, obviously, are not binding under this Act, they can and should be relied on for interpretive guidance; they provide a thoughtful analysis and resolution of several issues presented by participant-directed accounts. For example, to qualify as a § 404(c) plan under ERISA, a plan must (1) provide an opportunity for participants or beneficiaries to exercise control over assets in their accounts, including the opportunity to obtain sufficient information to make informed decisions on investment possibilities, and (2) provide participants and beneficiaries with a broad range of investment alternatives. 29 C.F.R. § 2550.404c-1 (1997). *See In Re Unisys Savings Plan Litigation*, 74 F.3d 420, 443-48 (3d Cir.), *cert. denied*, 117 S. Ct. 56 (1996). Similar requirements should apply to retirement programs seeking to fall under subsection (c).

Subsection (d) deals with a special problem that occurs when retirement system assets are placed in the general accounts of insurance companies. The essence of the problem is that, to the extent those assets are not used to support "guaranteed benefit policies" (which are exempted), the insurance companies will be subject to this Act's fiduciary duties when handling the assets. A central feature of those fiduciary duties is that the fiduciary must pay *exclusive* attention to the interests of participants and beneficiaries. State law, however, generally imposes a fiduciary obligation on insurers to attend to the interests of *all* those with investments in the insurer's general account, not just the interests of the retirement system's participants and beneficiaries. *See, e.g.*, N.Y. Ins. Law § 4224(a)(1) (McKinney Supp. 1997); Neb. Rev. Stat. § 44-1525(7) (Cum. Supp. 1996) (statutes prohibiting discrimination by insurance companies between contract holders). *See generally,* Stephen H. Goldberg & Melvin S. Altman, *The Case for the Nonapplication of ERISA to Insurers' General Account Assets*, 21 Tort & Ins. L.J. 475, 476-77 (1986); *Mack Boring & Parts v. Meeker Sharkey Moffitt*, 930 F.2d 267, 275 n. 17 (3rd Cir. 1991). Thus, application of this Act's fiduciary duties without modification would mean that, when an insurance company's general account includes retirement system assets, the company would be required by this Act to pay exclusive attention to the interests of participants and beneficiaries, but would be required by state insurance law to pay attention to the interests of all those with interests in the account, including many non-participants and non-beneficiaries.

Subsection (d) deals with this problem by modifying the Act's fiduciary duties for insurance companies handling retirement system assets in general accounts. In that situation, the insurer need not act exclusively for the benefit of participants and beneficiaries, but instead must act prudently taking into account all obligations supported by the general account.

This solution is a middle ground between alternatives suggested by the experience under ERISA. One alternative would be to say in Section 4 of this Act that retirement system assets held in an insurer's general account are not assets of the system. Until 1993, this was the generally accepted interpretation under ERISA, based on a 1975 Department of Labor interpretive bulletin. Interpretive Bulletin Relating to Prohibited Transactions, 29 C.F.R. § 2509.75-2(b)(1995), removed from C.F.R., 61 Fed. Reg. 33,847 (July 1, 1996) ("If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets"). This solution, in essence, would treat insurance companies like investment companies registered under the Investment Company Act of 1940 by deferring to other regulatory authority. For investment companies, the Act defers to the securities laws and their enforcement by the SEC and through private actions; for insurance companies, the deferral would be to state insurance law and its enforcement mechanisms. The Drafting Committee decided not to pursue this alternative primarily because it was not confident that state insurance law would always be adequate as an alternative regulatory and enforcement regime.

Another solution suggested by ERISA would be to apply the normal fiduciary obligations to insurance company general accounts, while providing a grandfather period that would permit insurers to adjust their contracts and practices to the new rules. This is the approach of ERISA after the 1996 enactment of the Small Business Job Protection Act. ERISA § 401(c), 29 U.S.C. § 1101(c) (19XX). This part of the Small Business Job Protection Act was a reaction to the Supreme Court's *Harris Trust* decision, in which it rejected the prior understanding that retirement system assets in an insurer's general account were not "assets of the system." *John Hancock Mutual Life Ins. Co. v. Harris Trust & Savings Bank*, 510 U.S. 86, 106-110 (1993). The Department of Labor is now engaged in a mandatory rule-making effort to provide guidance on the many issues raised by the Act. The Drafting Committee was reluctant to follow that path because it could not adequately address within the Act all of the likely issues that would arise, and the Act creates no agency which could issue rules to provide guidance.

SECTION 10. REVIEWING COMPLIANCE. In evaluating performance of a trustee or other fiduciary:

(1) Compliance by the trustee or other fiduciary with Sections 6 through 8 must be determined in light of the facts and circumstances existing at the time of the trustee or fiduciary's decision or action and not by hindsight.

(2) The trustee's investment and management decisions must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the program or appropriate grouping of programs.

Comment

Subsection (a) derives from Section 8 of the Prudent Investor Act, which draws upon Restatement of Trusts 3d: Prudent Investor Rule § 227, comment b, at 11. Trustees and fiduciaries are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard. In the language of law and economics, the standard is *ex ante*, not *ex post*.

Subsection (b) emphasizes the consolidated portfolio standard for evaluating investment decisions. An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other assets of the program or appropriate grouping of programs. This "sensible relation" should be supported by the statement of investment objectives and policies required by Section 8(b). In the retirement system setting, the term "portfolio" embraces all assets of a program or appropriate grouping of programs.

Subsection (b) also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. Returns correlate strongly with risk, but tolerance for risk may vary with the circumstances of the retirement program or appropriate grouping of programs. A program that has a large proportion of its participants and beneficiaries near and beyond retirement age may have a lower risk tolerance than a program that has a large proportion of young participants.

Subsection (b) follows Section 2(b) of the Uniform Prudent Investor Act, which in turn followed Section 227(a) of the Restatement of Trusts 3d: Prudent Investor Rule. For introductions to modern portfolio theory, and its application to trust investment law, which provide the intellectual underpinnings for all these provisions, see the discussion and reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent Investor Rule; Edward C. Halbach, Jr., *Trust Investment Law in the Third Restatement*, 27 Real Property, Probate & Trust J. 407 (1992); Jonathan R. Macey, An Introduction to Modern Financial Theory (American College of Trust & Estate

Counsel Foundation, 1991); Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986); Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. Rev. 52 (1987); R.A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983); John H. Langbein & Richard A. Posner, *The Revolution in Trust Investment Law*, 62 A.B.A. J. 887 (1976); Note, *The Regulation of Risky Investments*, 83 Harvard L. Rev. 603 (1970).

SECTION 11. FIDUCIARY LIABILITY.

(a) A trustee or other fiduciary who breaches a duty imposed by this [Act] is personally liable to a retirement system for any losses resulting from the breach and any profits made by the trustee or other fiduciary through use of assets of the system by the trustee or other fiduciary. The trustee or other fiduciary is subject to other equitable remedies as the court considers appropriate, including removal.

(b) An agreement that purports to limit the liability of a trustee or other fiduciary for a breach of duty under this [Act] is void.

(c) A retirement system may insure itself against liability or losses occurring because of a breach of duty under this [Act] by a trustee or other fiduciary.

(d) A trustee or other fiduciary may insure against liability or losses occurring because of a breach of duty under this [Act] if the insurance is purchased or provided either by the trustee or fiduciary personally or, on the trustee or fiduciary's behalf, by this State, the retirement system, a public employer whose employees participate in a retirement program served by the trustee or fiduciary, an employee representative whose members participate in a retirement program served by the trustee or fiduciary, or the trustee or fiduciary's employer.

Comment

Section 11 places primary responsibility for fiduciary violations on trustees and fiduciaries: They are liable in the first instance and subsections (b) through (d) regulate their ability to shift the liability to others. The Drafting Committee considered and rejected standards that would have eased the potential liability of trustees and fiduciaries for fiduciary violations. For example, the Committee considered holding trustees and fiduciaries liable only for knowing and willful violations. The Committee opted for the current approach for three principal reasons.

First, the current approach provides strong protection for the retirement system against losses resulting from fiduciary violations. Any lesser standard than the one in Section 11 would mean that a fiduciary violation could occur for which no one would be liable. For example, with a "knowing and willful" standard, any non-knowing or non-willful fiduciary violation resulting in a loss would impose a loss on the system that could not be recouped from the violator. A loss from a non-knowing or non-willful fiduciary violation is just as real as any other loss. The crucial question is who should bear the loss: The violator or the retirement system. The standard in Section 11 attempts to shield the system from the loss and impose it instead on the violator.

Second, the possibility of liability tends to focus the attention of trustees and fiduciaries on their fiduciary responsibilities. The deterrence function of this section will work well only if trustees and fiduciaries act with their responsibilities firmly in mind. The hope is that, if the deterrence function of the section works well, less unfortunate circumstances will arise in which the issue of fiduciary liability must be faced at all.

Finally, a standard that penalized trustees and fiduciaries only for knowing and willful violations of their fiduciary duties would tend to undermine, through a weak enforcement scheme, the strong statement of fiduciary duties articulated elsewhere in the Act. The enforcement scheme is intended to reaffirm, rather than diminish, the notion that the fiduciary duties of the Act are intended to be taken seriously.

The Drafting Committee also considered and rejected the possibility of easing the liability standard for trustees only, but not for other fiduciaries. In addition to the reasons above, the Committee rejected this possibility because the underlying standard of fiduciary conduct already distinguishes between trustees and other fiduciaries. Trustees are held to the standard of other trustees for similar systems facing similar circumstances. Thus, if the system is small and the trustees for such systems are generally fairly unsophisticated, the prudence standard applying to the trustees of the system will reflect that level of knowledge and competence. On the other hand, professional money managers will be held to the much higher level of knowledge and competence expected of them. Since the underlying standard of fiduciary conduct already distinguishes between trustees and other fiduciaries, the Drafting Committee thought it unnecessary to duplicate the distinction in the liability standard itself.

Subsection (a) provides equitable remedies only. The language providing for personal liability for losses should not be misunderstood as providing legal relief. The possibilities for recovery under subsection (a) track those noted by the Restatement of Trusts 2d in cases of breach of trust, and those remedies are exclusively equitable. Restatement of Trusts 2d § 205. The equitable nature of the available remedies is evident again later in this Act in the enforcement section and in the suggested approach to a statute of limitations. MPERS Act §§ 19(a), 20.

Subsection (a) is clear that only trustees and other fiduciaries under this Act can be liable for fiduciary violations under this Act. Since the definition of fiduciary in this Act follows ERISA, service providers, such as attorneys, accountants and actuaries, will generally not be fiduciaries under this Act. *See* 29 C.F.R. § 2509.75-5, D-1 (1997) ("attorneys, accountants, actuaries and consultants performing their usual professional functions will ordinarily not be considered fiduciaries"). As a result, they will not generally be subject to liability under this Act. Under ERISA, this result presents the possibility of no liability at all for these service providers - none under ERISA because they are not fiduciaries and none under other state law because of the broad preemptive effect of ERISA. *See Mertens v. Hewitt Assocs.*, 508 U.S. 248 (1993) (no money damages against a nonfiduciary under ERISA); *Reich v. Rowe*, 20 F.3d 25 (1st Cir. 1994) (no nonfiduciary liability under ERISA). *See also Mertens, supra,* 508 U.S. at 267 n. 2 (White, J., dissenting) ("it is difficult to imagine how any common-law remedy for [a breach by a nonfiduciary] could have survived enactment of ERISA's 'deliberately expansive' pre-emption provision"). *But see Custer v. Sweeney*, 89 F.3d 1156 (4th Cir. 1996) (ERISA does not preempt state causes of action against nonfiduciary service provider); *Airparts Co. v. Custom Benefit Services of Austin, Inc.*, 28 F.3d 1062 (10th Cir. 1994) (same). That is not a possibility under this Act, however, because it does not preempt other causes of action against service providers. Service providers would still be subject to actions outside this Act based on the terms of their contracts with retirement systems and on other independent sources of fiduciary or other obligations under state or federal law (such as actions alleging causes of action under agency, tort, or professional responsibility law).

Subsections (b) through (d) limit and regulate the ability of trustees and fiduciaries to shift to others any liability for fiduciary violations. Subsection (b) broadly prohibits any type of insurance or indemnification for fiduciary liability, unless the arrangement is permitted by subsection (c) or (d). Although subsection (b) is restrictive, note that it voids only agreements relieving a trustee or fiduciary from liability for *breaches* of fiduciary duty. Thus, as under ERISA, an agreement to cover the legal expenses of a trustee or fiduciary for *successful* defenses against claims of fiduciary violations would not be void. *See Packer Engineering, Inc. v. Kratville*, 965 F.2d 174 (7th Cir. 1992) (ERISA § 410(a) is not violated by agreement to indemnify fiduciaries for legal expenses incurred in successfully defending claims of fiduciary violations); *Moore v. Williams*, 902 F. Supp. 957 (N.D. Iowa 1995) (ERISA § 410(a) does not void agreement to cover legal expenses in defending claims of fiduciary violations; plan must forward to fiduciary money to cover expenses).

Subsection (c) permits retirement systems to pursue a wide variety of arrangements for insuring against losses resulting from fiduciary violations, ranging from self-insurance, to risk retention groups, to commercially-obtained fiduciary liability insurance. The decisions whether to insure and, if so, how to insure are, of course, fiduciary decisions that must be made carefully.

Subsection (d) permits trustees and fiduciaries to insure against losses resulting from fiduciary breaches, but only if the insurance is purchased on their own account or on the account of the State, the retirement system, a public employer, an employee representative, or their employer. These possibilities generally track those of ERISA. 29 C.F.R. § 2509.75-4 (1997) (ERISA fiduciaries can be indemnified by their own employers, employers who have employees covered by the plan served by the fiduciary, or employee representatives who have members covered by the plan). As with subsection (c), the intent is to permit a wide variety of arrangements.

Section 11 is intended to waive any sovereign immunity defense that might be asserted by a trustee or fiduciary. Similarly, it is intended to supersede any protection against liability otherwise available under state tort claims acts, and similar acts, that have replaced application of sovereign immunity in certain States. *See*, *Moore v. City of Lewiston*, 596 A.2d 612 (Me. 1991); *Harden v. State*, 434 N.W.2d 881 (Iowa), *cert. denied*, 493 U.S. 869 (1989). To the extent a state constitution limits the power of the legislature to waive sovereign immunity, the waiver under this Act should be interpreted to be as broad as constitutionally permissible. If the constitutional limitation is quite broad, the legislature may want to consider other alternatives for protecting against losses from fiduciary violations, such as mandatory bonding requirements. *See* Ga. Const. art. 1, § 2, ¶ IX (limiting ability of legislature to waive sovereign immunity for state officers and employees); ERISA § 412, 29 U.S.C. § 1111 (1994) (imposing bonding requirements).

In addition to monetary liability, Section 11(a) specifies removal as a permissible form of relief for a fiduciary violation, but does not specify any specific grounds for removal. This follows ERISA and the Restatement of Trusts 2d § 107. *See generally* Restatement of Trusts 2d § 107, Comment on Clause (a), at 235-37 (discussing grounds for court removal of a trustee).

This section derives from Sections 409 and 410 of ERISA, 29 U.S.C. §§ 1109, 1110 (1994).

[**SECTION 12. [OPEN OR PUBLIC] MEETINGS AND RECORDS.**

(a) A multimember body having authority to invest or manage assets of a retirement system may deliberate about, or make tentative or final decisions on, investments or other financial matters in executive session if disclosure of the deliberations or decisions jeopardizes the ability to implement a decision or to achieve investment objectives.

(b) A record of a retirement system that discloses deliberations about, or a tentative or final decision on, investments or other financial matters is not an [open or public] record under [the State Open Records Law] to the extent and so long as its disclosure jeopardizes the ability to implement an investment decision or program or to achieve investment objectives.]

Comment

Section 12 is intended to work in conjunction with the enacting State's open records and open meetings laws. "Open" or "public" would be used depending on the phraseology used in the particular State. Except for the narrow circumstances defined in this section, the substance, procedures, and sanctions of the State's open records and open meetings laws would apply. For example, if a State's open meetings law provided an exception for meetings to discuss pending litigation or personnel matters, that exception would also apply to retirement systems. Section 12 is intended to clarify application of the general openness principle of open records and open meetings laws in circumstances of special relevance to retirement systems, specifically, to safeguard the interest of the system in protecting the privacy of information when necessary to permit pursuit of an investment or financial strategy.

Section 12 is bracketed to account for local circumstances. In some States, for example, the open records and open meetings laws may already deal with these issues adequately, so that Section 12 is unnecessary. In other States, enacting these types of limits on public disclosure may present constitutional problems. *See* Mont. Const. art. II, § 9 (documents and deliberations must be open unless "demand of individual privacy clearly exceeds the merits of public disclosure").

SECTION 13. DISCLOSURE TO PUBLIC.

(a) An administrator shall prepare and disseminate:

(1) a summary plan description of each retirement program;

(2) a summary description of any material modification in the terms of the program and any material change in the information required to be contained in the summary plan description, to the extent the modification or change has not been integrated into an updated summary plan description;

(3) an annual disclosure of financial and actuarial status; and

(4) an annual report.

(b) An administrator shall make available for public examination in the principal office of the administrator and in other places if necessary to make the information reasonably available to participants:

(1) the governing law of the retirement program and system;

(2) the most recent summary plan description;

(3) summary descriptions of modifications or changes described in subsection (a)(2) that have been provided to participants and beneficiaries but have not yet been integrated into the summary plan description;

(4) the most recent annual disclosure of financial and actuarial status; and

(5) the most recent annual report.

(c) Upon written request by a participant, beneficiary, or member of the public, an administrator shall provide a copy of any publication described in subsection (b). Except as otherwise provided in Section 14(a), the administrator may charge a reasonable fee to cover the cost of providing copies. The administrator shall provide the copies within 30 days after the request or, if a fee is charged, within 30 days after receiving payment.

Comment

Sections 13 to 18 contain the reporting and disclosure requirements of the Act. Three types of reports must be produced and distributed by each retirement system. In general terms, they are:

(1) A summary plan description (and updates). Basically, this is a description of the retirement program and its benefits. It must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

(2) An annual disclosure of financial and actuarial status. This is a compilation of a great deal of information about the retirement system and program, its financial position, and, for defined benefit plans, its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system.

(3) An annual report. This is a summary of the annual disclosure of financial and actuarial status. It must contain certain key financial information and, for defined benefit plans, key actuarial information. The annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

Subsection (b) requires the administrator to make information available for public examination in the principal office of the administrator and in other places "if necessary to make the information reasonably available to participants." This latter requirement is intended to ensure that, whenever reasonably possible, the materials are readily available to participants who live some distance from the principal office. The requirement should never be read to require the establishment of a branch office, but it may require that materials be made available in a branch office already in existence or on the premises of a major public employer participating in the system. The major factors determining when the information must be made available in a place other than the principal office are the distance from the principal office; the number of participants who live in the remote area; and the cost of making the information available.

Subsection (c) is not intended to preclude or discourage retirement systems from accepting and responding to requests for information made by telephone or electronically. The subsection, however, does protect systems by providing that an enforceable obligation to provide information arises only when a request is made in writing.

Subsections (b) and (c) of this section are based generally on ERISA §§ 104(b)(2) and (4), 29 U.S.C. §§ 1024(b)(2) and (4) (1994).

SECTION 14. DISCLOSURE TO PARTICIPANTS AND BENEFICIARIES.

(a) An administrator shall furnish to each participant and to each beneficiary who is receiving benefits under a retirement program:

(1) a copy of the most recent summary plan description, along with any summary descriptions of modifications or changes described in Section 13(a)(2), within [three] months after a person becomes a participant or, in the case of a beneficiary, within [three] months after a person first receives benefits, or, if later, within [four] months after the retirement program becomes subject to this [Act];

(2) the summary description of any modifications or changes described in Section 13(a)(2), within [seven] months after the end of the fiscal year in which a modification or change has been made;

(3) a copy of an updated summary plan description that integrates all modifications and changes at intervals not exceeding five years; and

(4) the annual report within [seven] months after the end of each fiscal year.

(b) An administrator shall provide to a participant or beneficiary a statement containing information that would permit the participant or beneficiary to estimate projected benefits reasonably, to the extent the information is regularly maintained by the retirement system. The information must be provided with the annual report or upon written request of the participant or beneficiary. The information need not be provided to a participant or beneficiary who is currently receiving benefits.

(c) A participant who is not currently receiving benefits is entitled without charge to one statement under subsection (b) during any fiscal year. An administrator may charge a reasonable fee to cover the cost of providing other statements. The administrator shall provide the statements within 30 days after the participant or beneficiary's request or, if a fee is charged, within 30 days after receiving payment.

Comment

Subsection (a) specifies the types and timing of reports that must be distributed to participants and beneficiaries receiving benefits. The types and times generally follow ERISA. ERISA § 104(b), 29 U.S.C. § 1024(b) (1994). Most of the time limits are in brackets to permit adjustment for local circumstances.

Participants and eligible beneficiaries need only receive the annual report, which is a summary of the annual disclosure of financial and actuarial status. They need not be furnished with the annual disclosure of financial and actuarial status itself. There are two primary reasons for this. First, the annual disclosure of financial and actuarial status is quite comprehensive. It would be extremely burdensome on retirement systems to require broad distribution of such a large report. Second, the requirement attempts to make the appropriate trade-off between comprehensiveness and comprehensibility. The goal is to provide participants and beneficiaries with sufficient information to inform them clearly and adequately, without overwhelming them with detail. Additional detail is available to interested parties in the annual disclosure of financial and actuarial status itself. The obligation to supply only the annual report, and not the annual disclosure of financial and actuarial status, aligns with notice requirements elsewhere in pension law that recognize that "[c]larity and completeness are competing goods." *Lorenzen v. Employees Retirement Plan of the Sperry & Hutchinson Co.*, 896 F.2d 228, 236 (1990) (holding that a summary plan description need not detail every contingency). *See* Disclosure to Participants, 60 Fed. Reg. 34,412, 34,412 (1995) (PBGC rejects claims that more information should be provided in notice of underfunded status, emphasizing that information should be "clear, concise, and focused").

Subsections (b) and (c) require the administrator to provide information that will permit participants and beneficiaries to estimate their benefits reasonably, to the extent the information is regularly maintained by the retirement system. Consequently, retirement systems would normally provide information on all the factors necessary to estimate projected benefits, such as the participant's salary history (to the extent relevant to benefit determination), years of service credit, contributions, and vesting status. Not all retirement systems regularly maintain information on all these factors. For example, not all systems maintain information on each participant's salary history. In that case, the administrator need only provide information that the system regularly maintains. The administrator need not provide this type of information to participants and beneficiaries who are currently receiving benefits, as they will already know the level of benefits they are receiving.

Subsections (b) and (c) are based generally on ERISA §§ 105(a) and (b), 29 U.S.C. §§ 1025(a) and (b) (1994).

SECTION 15. REPORTS TO [AGENCY]. An administrator shall file with the [Agency] [and others] a copy of:

(1) the governing law of the retirement program and system within [four] months after the system becomes subject to this [Act] and an updated copy at least once every year thereafter;

(2) the summary plan description within [four] months after the system becomes subject to this [Act] and of updated summary plan descriptions at the same time they are first furnished to any participant or beneficiary under Section 14(a)(3);

(3) any summary description of modifications or changes within [seven] months after the end of the fiscal year in which a modification or change has been made; and

(4) the annual disclosure of financial and actuarial status and annual report within [seven] months after the end of each fiscal year.

Comment

This section requires reports to be filed with an agency. The intent is to create a central repository of information on all retirement programs and systems in a State. Designation of the entity is left to the discretion of the enacting State, but the designation should be to an entity that can fulfill the two intended functions under the Act: (1) to serve as a central and easily accessible repository of information and (2) to enforce the obligation to file the required materials. States currently allocate similar responsibilities to a variety of entities, including specialized agencies whose primary responsibility is to oversee public retirement systems; agencies with more general responsibilities, one of which is oversight of retirement systems; various executive branch officials, such as the Attorney General or State Auditor; and specialized legislative bodies. The enacting State could designate any of these entities, or another, as the "Agency."

Enacting States may also want to require the administrator to file the information required by this section with entities other than the designated agency, such as employers participating in programs managed by the retirement system, legislative oversight committees, or various executive branch officials. The purpose of requiring such additional filings would not be primarily to create a central repository of information (that function would be served by the filing with the designated agency), but rather to ensure that information about the retirement system is made available to entities with special interest in its functioning. The area with the bracketed language "and others" is reserved for designation of these other entities.

SECTION 16. SUMMARY PLAN DESCRIPTION.

(a) A summary plan description and a summary description of modifications or changes under Section 13(a)(2) must be written in a manner calculated to be understood by the average participant and be accurate and sufficiently comprehensive reasonably to inform the participants and beneficiaries of their rights and obligations under the retirement program.

(b) A summary plan description must contain:

(1) the name of the retirement program and system and type of administration;

(2) the name and business address of the administrator;

(3) the name and business address of each agent for service of process;

(4) citations to the governing law of the retirement program and system;

(5) a description of the program's requirements respecting eligibility for participation and benefits;

(6) a description of the program's provisions providing for nonforfeitable benefits;

(7) a description of circumstances that may result in disqualification, ineligibility, or denial or loss of benefits;

(8) a description of the benefits provided by the program, including the manner of calculating benefits and any benefits provided for spouses and survivors;

(9) the source of financing of the program;

(10) the identity of any organization through which benefits are provided;

(11) the date the fiscal year ends;

(12) the procedures to claim benefits under the program and the administrative procedures available under the program for the redress of claims that are denied in whole or in part; and

(13) notice of the availability of additional information pursuant to Sections 13(b), 13(c), 14(b), 14(c), and 15.

Comment

The primary purpose of the summary plan description is to inform participants and beneficiaries of benefits available under their retirement program. Consequently, the administrator must produce and distribute a summary plan description for each retirement program. Section 16 is based generally on ERISA § 102, 29 U.S.C. § 1022 (1994).

Subsection (b) lists elements that must be included in every summary plan description. The description of benefits required by paragraph (8) should cover all benefits provided by a program including, where appropriate, a discussion of any options to purchase service credit. Where appropriate, information additional to that listed in subsection (b) may be included in the summary plan description, such as citations to applicable collective bargaining agreements or information on the availability of retirement planning services.

SECTION 17. ANNUAL DISCLOSURE OF FINANCIAL AND ACTUARIAL STATUS.

(a) As used in this section, "qualified public accountant" means:

(1) an auditing agency of this State, or a political subdivision of this State, which has no direct relationship with the functions or activities of a retirement system or its fiduciaries other than:

(A) functions relating to this [Act]; or

(B) a relationship between the system and the agency's employees as participants or beneficiaries on the same basis as other participants and beneficiaries; or

(2) a person who is an independent public accountant, certified or licensed by a regulatory authority of a State.

(b) As used in this section, "related person" of an individual means:

(1) the individual's spouse or a parent or sibling of the spouse;

(2) the individual's descendant, sibling, or parent, or the spouse of the individual's descendant, sibling, or parent;

(3) another individual residing in the same household as the individual;

(4) a trust or estate in which an individual described in paragraph (1), (2), or (3) has a substantial interest;

(5) a trust or estate for which the individual has fiduciary responsibilities; or

(6) an incompetent, ward, or minor for whom the individual has fiduciary responsibilities.

(c) An annual disclosure of financial and actuarial status must contain:

(1) the name of the retirement system and identification of each retirement program and, if programs are in an appropriate grouping of programs, of each appropriate grouping of programs;

(2) the name and business address of the administrator;

(3) the name and business address of each trustee and each member of a board of trustees and a brief description of how the trustee or member was selected;

(4) the name and business address of each agent for service of process;

(5) the number of employees covered by each retirement program not in an appropriate grouping of programs, or by each appropriate grouping of programs, or both;

(6) the name and business address of each fiduciary;

(7) the current statement of investment objectives and policies required by Section 8(b);

(8) financial statements and notes to the financial statements in conformity with generally accepted accounting principles;

(9) an opinion on the financial statements by a qualified public accountant in conformity with generally accepted auditing standards;

(10) in the case of a defined benefit plan, actuarial schedules and notes to the actuarial schedules in conformity with generally accepted actuarial principles and practices for measuring pension obligations;

(11) in the case of a defined benefit plan, an opinion by a qualified actuary that the actuarial schedules are complete and accurate to the best of the actuary's knowledge, that each assumption and method used in preparing the schedules is reasonable, that the assumptions and methods in the aggregate are reasonable, and that the assumptions and methods in combination offer the actuary's best estimate of anticipated experience;

(12) a description of any material interest, other than the interest in the retirement program itself, held by any public employer participating in the system or any employee organization representing employees covered by the system in any material transaction with the system within the last three years or proposed to be effected;

(13) a description of any material interest held by any trustee, administrator, or employee who is a fiduciary with respect to the investment and management of assets of the system, and, if the fiduciary is an individual, by a related person of the beneficiary, in any material transaction with the system within the last three years or proposed to be effected;

(14) a schedule of the rates of return, net of total investment expense, on assets of the system overall and on assets aggregated by category over the most recent one-year, three-year, five-year, and 10-year periods, to the extent available, and the rates of return on appropriate benchmarks for assets of the system overall and for each category over each period;

(15) a schedule of the sum of total investment expense and total general administrative expense for the fiscal year expressed as a percentage of the fair value of assets of the system on the last day of the fiscal year, and an equivalent percentage for the preceding five fiscal years; and

(16) a schedule of all assets held for investment purposes on the last day of the fiscal year aggregated and identified by issuer, borrower, lessor, or similar party to the transaction stating, if relevant, the asset's maturity date, rate of interest, par or maturity value, number of shares, cost, and fair value and identifying any asset that is in default or classified as uncollectible.

Comment

The annual disclosure of financial and actuarial status is intended to make information available to interested persons sufficient to enable them to assess the management, financial position, and, if applicable, actuarial position of each retirement program. The annual disclosure of financial and actuarial status requires the disclosure of a great deal of information, but its distribution list is extremely limited. In essence, the annual disclosure is a filing requirement rather than a publication requirement.

Subsection (c)(8) requires that the annual disclosure contain financial statements and notes in conformity with generally accepted accounting principles. The principal current articulation of those principles is GASB Statement No. 25, which requires two financial statements (a statement of plan net assets and a statement of changes in net plan assets) and accompanying notes. GASB Statement No. 25 also addresses a multitude of other issues that must be addressed in preparing the financial statements and notes. *See also* Government Finance Officers Ass'n, Pension CAFRs: Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report 9-28 (1996) (hereinafter "Pension CAFRs").

Subsection (c)(10) requires the annual disclosure for defined benefit plans to contain actuarial schedules and notes in conformity with generally accepted actuarial principles and practices for measuring pension obligations. The principal current articulations of these principles and practices are GASB Statement No. 25 and Measuring Pension Obligations, Actuarial Standard of Practice No. 4 (Actuarial Standards Board, 1993) (hereinafter "Actuarial Standard of Practice No. 4"). GASB Statement No. 25 requires two actuarial schedules (a schedule of funding progress and a schedule of employer contributions) and accompanying notes. The actuarial disclosures, however, need not be limited to the disclosures required by these sources. Those preparing actuarial statements may also be subject to guidelines from other sources that suggest or require more extensive disclosure. *See* Pension CAFRs, at 35-43. Complying with these guidelines and including other actuarial information in the annual disclosure would be consistent with this subsection, provided that all the information required by generally accepted actuarial principles and practices is also disclosed.

Subsection (c)(11) requires actuarial assumptions and methods to be reasonable both individually and in the aggregate. This follows the guidelines of Actuarial Standard of Practice No. 4, § 5.2.4. The subsection is based on ERISA and the Internal Revenue Code, but differs from them on the issue of assumptions and methods. ERISA requires the assumptions and methods to be reasonable only in the aggregate, ERISA § 103(a)(4)(B)(i), 29 U.S.C. § 1023(a)(4)(B)(i) (1994), while the Internal Revenue Code requires them to be reasonable either in the aggregate or individually for non-multiemployer plans and reasonable in the aggregate for multiemployer plans. I.R.C. § 412(c)(3) (1994).

Subsection (c)(12) and (13) requires disclosure of information about significant actors of the retirement system. As indicated in the Comment to Section 7 above, this disclosure requirement supports the fiduciary sections of the Act by exposing and discouraging improper transactions between a retirement system and significant actors. At the same time, the subsection should not impose significant extra burdens on retirement systems; investigating these types of interests are already a standard part of the auditor's duties. *See* American Institute of Certified Public Accountants, Audits of Employee Benefit Plans, §§ 11.01-11.16 (1995).

The definition of related person in subsection (b) supports the disclosure requirement in subsection (c)(13). The definition tracks the definition of the same term in the Model Business Corp. Act § 8.60(3) (Business Law Section, ABA, 1984). The Model Business Corp. Act's definition of "related person" is currently in the statutes of nine States.
Subsection (c)(14) and (15) uses the terms "investment expense" and "general administrative expense." These are terms that are used and discussed in GASB Statement No. 25. GASB Statement No. 25, ¶¶ 29-30, 103-104, 107. As a result, the terms have a well-settled meaning amongst professionals in the field, even though gray areas of application that call for the exercise of professional judgement will inevitably arise. *See id*. at ¶ 107 (difficulties in separating investment expenses from investment income and general administrative expenses call for the exercise of professional judgement).

The annual disclosure of financial and actuarial status need not be limited to the disclosures required by this section. The disclosure may also include other information that, although not required by this section, would assist recipients in assessing the status of the retirement system. For example, the annual disclosure of financial and actuarial status might include additional information of the type generally included in a comprehensive annual financial report, such as additional investment and statistical information. Pension CAFRs, at 29-33, 45-48.

SECTION 18. ANNUAL REPORT. An annual report must contain:

(1) the name and business address of each trustee and each member of a board of trustees;

(2) the financial statements, but not the notes, required by Section 17(c)(8);

(3) for defined benefit plans, the actuarial schedules, but not the notes, required by Section 17(c)(10);

(4) the schedules described in Section 17(c)(14) and (15).

(5) a brief description of and information about how to interpret the statements and schedules;

(6) other material necessary to summarize fairly and accurately the annual disclosure of financial and actuarial status; and

(7) notice of the availability of additional information pursuant to Sections 13(b), 13(c), 14(b), 14(c), and 15.

Comment

The annual report, as indicated in the Comment to Section 14 above, is intended to provide participants and beneficiaries with sufficient information to inform them clearly and adequately about the status of the system, without overwhelming them with detail. Additional detail is available to interested parties in the annual disclosure of financial and actuarial status itself.

This section does not require voluminous amounts of information to be included in the annual report. Subsections (2) and (3) require financial statements and actuarial schedules to be included in the annual report, but not the notes to the statements and schedules. The statements and schedules themselves are generally considerably more concise than the notes that accompany them. Subsection (4) requires the schedules described in Section 17(c)(14) and (15) to be included in the annual report. It should also be possible to present these schedules concisely. *See* Pensions CAFRs, at 30 (presenting a half-page schedule presenting the type of information required by Section 17(c)(14)). Similarly, the information required by subsections (5) through (7) should not be lengthy. The goal, once again, is to provide fair notice of the current status of the system, rather than to provide a large amount of information. More information is available for those who desire it in the annual disclosure of financial and actuarial information.

Retirement systems currently produce and distribute publications that, with minor modification, may satisfy the requirement to produce and furnish an annual report. For example, some systems currently distribute summaries of their comprehensive annual financial report or component unit financial report to all participants and beneficiaries receiving benefits. With only minor modifications, these summaries could constitute the annual report required by this section. These systems, then, could meet the annual report requirement with virtually no increase in their marginal costs. Similarly, most systems currently produce and distribute a newsletter of one sort or another to all participants and beneficiaries receiving benefits. Some systems already use their newsletters to convey virtually all of the information required to be in an annual report. With only slight modifications, these newsletters could satisfy the annual report requirement. Other systems devote considerable newsletter space to information that is less than essential, for example, information on how to protect yourself against Lyme disease or on how members have done at the most recent state senior games. These systems could meet the annual report requirement by replacing that information with the information required to satisfy the annual report requirement. In both of these situations, once again, the annual report requirement could be met with virtually no increase in marginal costs.

Retirement systems that do not currently communicate with participants and beneficiaries receiving benefits will incur a new, and not insignificant, expense because of the obligation to produce and distribute an annual report. Two points about this expense should be noted, however. First, annual report aside, most systems currently communicate with their participants and beneficiaries through a newsletter or even a more expensive publication. Thus, most systems currently think that the expense of this type of communication is justified. The Act may well have a beneficial side-effect if it encourages retirement systems that engage in only very limited communication with participants and beneficiaries to reconsider that policy. Second, the annual report, like the current newsletters, need not be a glossy, professionally-produced document. Some newsletters are that way, but others are very modest, typewritten documents. Either type could be used to meet the annual report requirement. The expense of satisfying the requirement will never disappear, but it can be minimized.

The annual report requirement of this section is met if the required information is communicated to participants and beneficiaries receiving benefits in a timely fashion. The annual report need not be labeled "The Annual Report," it need not be separate from other reports, and it need not be limited to the information specified by this section.

SECTION 19. ENFORCEMENT.

(a) A public employer, participant, beneficiary, or fiduciary may maintain an action:

(1) to enjoin an act, practice, or omission that violates this [Act];

(2) for appropriate equitable relief for breach of trust under Section 11; or

(3) for other appropriate equitable relief to redress the violation of or to enforce this [Act].

(b) [The Agency] may maintain an action to enjoin a violation of Section 15.

(c) In an action under this section by a participant, beneficiary, or fiduciary, the court may award reasonable attorney fees and costs to either party.

Comment

This section is based generally on ERISA § 502, 29 U.S.C. § 1132 (1994). The section applies only to enforcement of this Act. Unlike ERISA, this Act does not preempt other possible causes of action. Thus, many actions against retirement systems (for example, actions to collect benefits) may be permissible, but are not provided for in this section. Such actions must be based elsewhere in state or federal law.

Subsections (a) and (b) provide only for equitable relief. This has two important effects that, although fairly obvious, are worth noting. First, damages are limited to traditional equitable remedies, such as injunctions and restitution. Other forms of relief, such as compensatory and punitive damages, are not available under the Act. Second, jury trials are not available under the Act.

Subsection (c) authorizes a court to award an attorney's fee and costs to either party. Subsection (c) is based on § 502(g)(1) of ERISA, 29 U.S.C. § 1132(g)(1) (1994), but differs from the ERISA provision in that it does not use the phrase "in its discretion" to describe the court's authority to award attorney's fees and costs. This was a stylistic, rather than a substantive, change. The subsection says that the court "may" award fees and costs and, hence, is intended to follow § 502(g)(1) in authorizing, but not requiring, courts to award them. Consequently, since the provision tracks ERISA, it would be appropriate for courts exercising their discretion under this section to rely on the factors developed under ERISA for determining whether an award of attorney's fees is appropriate. *See Eaves v. Penn*, 587 F.2d 453, 464-65 (10th Cir. 1978) (first case to articulate five factors relevant to fee determination under ERISA); *Eddy v. Colonial Life Ins. Co.*, 59 F.3d 201, 206-07 (D.C. Cir. 1995) (citing cases indicating that all circuits apply the five-factor test).

Subsection (c) does not authorize an award of attorney's fees and costs for every type of plaintiff who might bring an action under the section. The primary purpose of the provision is to facilitate appropriate enforcement actions by those who might sue not only on their own behalf, but also on behalf of others. In the absence of a provision shifting fees and costs, one would expect too little enforcement because this type of plaintiff would bear all the costs of an enforcement action, but would recoup only a small share of the benefits of a successful action. *See generally* Mancur Olson, The Logic of Collective Action 30-31 (1965). Subsection (c) authorizes attorney's fees and costs only in actions brought by a participant, beneficiary, or fiduciary. These are actions in which the plaintiff is likely to be forwarding the interests of others, as well as its own. This provision facilitates such actions by making the anticipated costs of the action align more closely with the benefits anticipated by the individual plaintiff. Subsections (a) and (b) also permit actions to be brought by a public employer or the agency designated by the Act. An award of attorney's fees and costs is not authorized for those actions. The conditions that might lead to under-enforcement through actions by participants, beneficiaries, and fiduciaries are less likely to be present in actions brought by public employers or the designated agency. *Cf. Self-Insurance Institute of America, Inc. v. Korioth*, 53 F.3d 694, 696-97 (5th Cir. 1995) (attorney's fees denied under ERISA because prevailing plaintiff was not a participant, beneficiary or fiduciary); *Associated Gen. Contractors v. Smith*, 74 F.3d 926, 930-31 (9th Cir. 1996) (attorney's fees denied under another federal statute since prevailing plaintiff would not have been able to recover fees under ERISA because not a participant, beneficiary or fiduciary).

Although subsection (c) authorizes an award of attorney's fees to either party, the public goods rationale underlying the provision suggests that courts should not treat claims by prevailing plaintiffs and defendants the same. Courts applying ERISA's attorney's fees provision, which has the same operative language as this provision, have generally looked favorably on claims for attorney's fees from prevailing plaintiffs, but skeptically at claims for fees from prevailing defendants. *See Rodriquez v. MEBA Pension Trust*, 956 F.2d 468 (4th Cir. 1992) (stating presumption in favor of attorney's fees to prevailing plaintiffs); *Eddy v. Colonial Life Ins. Co.*, 59 F.3d 201 (D.C. Cir. 1995) (rejecting presumption in favor of prevailing plaintiffs, but nevertheless applying five-factor test to overturn lower court's denial of fees); *Tingey v. Pixley-Richards West, Inc.*, 958 F.2d 908, 909 (9th Cir. 1992) (denying attorney's fees to prevailing defendant, while indicating that fees should seldom be awarded to prevailing defendants); *Nachwalter v. Christie*, 805 F.2d 956, 962 (11th Cir. 1986) (same as *Tingey*). At the same time, however, ERISA does confer discretion on the courts so that, in compelling circumstances, attorney's fees can be denied to prevailing plaintiffs or awarded to prevailing defendants. *See Armistead v. Vernitron Corp.*, 944 F.2d 1287 (6th Cir. 1991) (denying attorney's fees to prevailing plaintiffs because success did not confer adequate common benefit on others); *Credit Managers Ass'n v. Kennesaw Life & Accident Ins. Co.*, 25 F.3d 743 (9th Cir. 1994) (awarding attorney's fees to prevailing defendant when plaintiff acted in bad faith by pursuing "groundless" claims). This same approach has been applied to the attorney fees provisions of the major civil rights statutes. *See* Title VII, § 706(k), 42 U.S.C. § 2000e-5(k) (1994); 42 U.S.C. § 1988 (1994). These provisions authorize the courts to award attorney's fees to any "prevailing party," but the courts have interpreted the language to mean that prevailing plaintiffs will almost always receive an award of attorney's fees, while a prevailing defendant will almost always be denied attorney's fees. *See Newman v. Piggie Park Enter.*, 390 U.S. 400 (1968) (prevailing plaintiffs should ordinarily recover attorney's fees unless special circumstances render an award unjust); *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412 (1978) (prevailing defendants should recover attorney's fees only if plaintiff's action was frivolous, unreasonable, or without foundation). Subsection (c) should also be interpreted in this way.

[**SECTION 20. STATUTE OF LIMITATIONS.** An action under Section 19 must be commenced within the period of limitations in this State, if any, for actions for breach of trust or, if none, within three years.]

Comment

This section is intended to alert States to the need to provide a statute of limitations for actions arising under the Act and to provide general guidance. The section is bracketed because States differ in a number of ways which may affect the precise way in which a statute of limitations might be implemented. For example, some States, but not others, have general statute-of-limitations provisions which are codified separately and which may deal adequately with issues, such as discovery and tolling, that are likely to be salient in this context. Similarly, some States, but not others, may provide for administrative review of decisions subject to this Act and those procedures may deal adequately with limitations issues. The Drafting Committee thought it inadvisable to attempt to deal with the many difficult and technical issues that arise in connection with a statute of limitations given the diversity of ways in which the States deal with statutes of limitations generally. At the same time, it wanted to alert States to the need to attend to these issues when the Act is enacted.

SECTION 21. ALIENATION OF BENEFITS. Benefits of a retirement program may not be assigned or alienated and are exempt from claims of creditors, except [to the extent expressly permitted by other law of this State].

Comment

This section states the well-accepted general rule that benefits from retirement programs cannot be assigned or alienated. The section recognizes, however, that in certain limited circumstances the legislature may decide that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits. A number of States, for example, permit alienation for domestic relations orders and participant loans. Instead of attempting to list every circumstance in which the legislature might make such a determination, the bracketed language states that the general anti-alienation rule of this section shall yield to state laws that expressly permit assignment or alienation of retirement benefits. The "expressly permitted" language imposes the burden of proving an exemption on those seeking an exemption and requires proof of unmistakable legal language indicating that the appropriate authority has actually considered the question of an exemption and determined that one is warranted. For analogous language in other uniform laws, see U.C.C. § 2A-104 (1990); U.C.C. § 9-203(4) (1977); Model State Administrative Procedure Act, § 1-103(b) (1981). This language is bracketed because some States may prefer to insert their particular exceptions, or provide cross-references to them, instead of using the generic language suggested.

SECTION 22. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this [Act], consideration must be given to the need to promote uniformity of the law with respect to its subject among States that enact it.

SECTION 23. SEVERABILITY. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 24. EFFECTIVE DATE. This [Act] takes effect ....

SECTION 25. REPEALS. The following acts and parts of acts are repealed:

(1) ....

(2) ....

(3) ....

SECTION 26. SAVINGS AND TRANSITIONAL PROVISIONS. [Before January 1, 1999, this [Act] does not apply to an eligible deferred compensation plan that was in existence on August 20, 1996, and satisfies the requirements of Section 457 of the Code, unless all assets and income of the plan are held in trust for the exclusive benefit of participants and their beneficiaries.]

Comment

This section is transitional only. It provides a limited exception from the Act only until January 1, 1999. On that date and thereafter, the provision should not be included in the Act, as it would have no effect.

This section deals with a special problem posed by eligible deferred compensation plans under Section 457 of the Internal Revenue Code. Prior to the Small Business Job Protection Act, the assets of a Section 457 plan had to remain solely the property of the employer and subject to the claims of the employer's general creditors. I.R.C. § 457(b)(6) (1994). These requirements were inconsistent with both the general approach and specific obligations of this Act, which require that the assets of retirement plans be held in trust solely for the benefit of participants and beneficiaries. As a result, early drafts of this Act provided that Section 457 plans were not subject to the Act.
In the Small Business Job Protection Act, Congress amended this part of Section 457. New subsection (g)(1) now provides that all assets and income of a Section 457 plan must be "held in trust for the exclusive benefit of participants and their beneficiaries." Small Business Job Protection Act, Pub. L. No. 104-188, § 1448(a), 110 Stat. 1755, 1812-13 (1996) (to be codified at I.R.C. § 457(g)). New subsection (g)(3) makes it clear that the trust requirement may be satisfied either through the creation of a trust or through the establishment of custodial accounts or contracts described in section 401(f) of the Code. *Id.* The Act also provides, however, that Section 457 plans in existence on the enactment date of the Small Business Job Protection Act (August 20, 1996) are not required to comply with the new trust requirement until January 1, 1999. *Id.* at § 1448(c), 110 Stat. at 1813.

This section provides an exception for Section 457 plans that have not yet been amended to comply with the new trust requirement of the Small Business Job Protection Act. Those plans are exempt from this Act. On the other hand, as soon as a plan complies with the new trust requirement of Section 457(g), either through the creation of a trust or pursuant to subsection (g)(3), it also becomes subject to the obligations of this Act.