

# FUNDAMENTAL FIDUCIARY CONDUCT

Board of Administration  
San Jose Federated City  
Employees' Retirement  
System

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# WHAT IS A FIDUCIARY?

- Somebody entrusted to manage the assets of others with complete and singular devotion
- A position of trust and reliance to act on behalf of others in a position of vulnerability
- A role with the highest legal duties imposed on it

# WHY ARE THERE FIDUCIARY RULES ANYWAY?

To overcome human nature: Looking out for our own interests, not the interests of others

- Doing something for our own gain or those we like
- Doing something to disadvantage those we don't like
- Acting on our known and unknown biases
- Going along with the group to avoid controversy
- Bowing to pressure from others that don't share our responsibility
- Making snap judgments
- Easier spending others' money, especially when there is a lot of it
- Rationalizing actions we know are wrong
- Making "back-room" deals

# FIVE FUNDAMENTAL FIDUCIARY DUTIES

1. Duty of Loyalty. You owe your primary duty to members and beneficiaries of the trust. All other obligations are subordinated.
2. Exclusive Benefit Rule. The assets of the trust may be used only to pay benefits and *reasonable* administrative expenses.
3. Prudent Expert Rule. You must exercise the care and skill of a knowledgeable, prudent person charged with similar duties. And assure the competency of the assets of the trust.
4. Diversify Investments. You must broadly diversify the portfolio unless it is imprudent to do so (aka "Modern Portfolio Theory.")
5. Follow the law. You must obey the plan documents, which includes the law, policies, regulations and governing documents of the trust.

# BEING A *PUBLIC* TRUSTEE IS UNIQUE!

1. Transparency
2. Collective decision making
3. Conflicts of interest
4. Impartiality and fairness
5. Delegation of duties

# 1. TRANSPARENCY

- Open meeting laws (Brown Act)
  - Public's right to know and participate
  - Published agendas, open meetings, limited confidentiality
  - No "behind-the-scenes" board communications
- Public records laws
  - Public's right to know and access
  - Includes all media used to communicate public business
  - Limited non-disclosure permitted

## 2. COLLECTIVE DECISION-MAKING

- Diverse board composition
  - Appointed and elected members
  - “Interested” but not representative
- Follow a prudent decision-making process
  - Broad discretion, but must be reasoned
  - No liability for breach of fiduciary duty, so long as the board acts in a prudent manner
  - Right to immunity, indemnification and defense
- Majority rules; decisions should be supported

# THE MOST RECENT COURT RULING ON BOARD DISCRETION

- *O'Neal v. StanCERA*, trial court, Feb. 2019:

*"When faced with what amounted to a 'five-alarm fire,' the Board properly exercised its due diligence, considered its options (as presented to it by its actuarial and fiduciary/legal advisors), and acted as cautiously and conservatively as possible to insure the certainty that its members would receive all vested benefits over time."*

- *Accord, Nasrawi v. Buck*, appellate court, 2014:

*"The decision, requiring as it does, comparisons, choices, judgments, and evaluations, comprises the very essence of the exercise of 'discretion' and we conclude that such decisions are immunized..."*



### 3. AVOIDING CONFLICTS OF INTEREST

- Critical duty of loyalty – a public trustee cannot serve two masters, one the members and the other herself (or others)
- Most serious of all fiduciary duties; severe penalties for breach, including fines and imprisonment
- Impacts all decisions: contracts, hiring of consultants and vendors, relations with the County and districts, unions, retirees, personal business interests, litigation, etc...
- Being independent and avoiding undue influence is essential
- Rules are complicated and often not intuitive; seek counsel when in doubt

## 4. MAINTAINING IMPARTIALITY AND FAIRNESS

- Board is arbiter of members' rights
- Fundamental due process assures members of fairness in making benefit decisions
- Impartiality assures consultants and vendors of a level competitive playing field, for the benefit of the trust
- Impartiality assures fair balancing of active and retired members' interests

## 5. DELEGATION AND OVERSIGHT

- A public fiduciary may (often must!) delegate, but only to others who are held to the same fiduciary standards
- No “set and forget” – Prudent delegation requires vigilant oversight: Monitoring, auditing, adjusting, terminating when necessary
- Board engages oversight advisors (auditors, consultants, fiduciary counsel, etc.) to help monitor activities of staff, consultants, investment managers

# GOOD FIDUCIARY CONDUCT INCLUDES...

1. Adhering to fundamental fiduciary duties
2. Obeying conflict of interest laws and CCCERA's Conflicts Code
3. Avoiding activities that improperly influence or impair your judgment, or are inconsistent with your duty to act in the best interest of the system
4. Disclosing conflicting interests; recuse when appropriate and timely
5. Complying with all legal limitations on gifts and things of value
6. Honoring the "quiet period" during investment manager searches
7. Avoiding using your public position for private gain or influence
8. Maintaining the confidentiality of closed sessions
9. Conducting yourself with civility and respect at board meetings
10. Using care in communications with service providers, members, plan sponsors, media and the public

# THE FIVE FIDUCIARY PILLARS

## Primary Loyalty to Members



- Fund the promised benefits timely
- Avoid “two hat” conflicts of interest
- Attract and retain capable staff
- Provide superior member service
- Minimize risk of loss

## Exclusive Benefit of Members



- Avoid diverting assets for other purposes
- Avoid impacting the plan for others’ goals
- Pay only reasonable expenses to administer fund

## Prudent Care and Expertise



- Establish and follow good governance policies as a Board
- Be transparent
- Engage and delegate to expert staff and consultants
- Monitor and adjust as needed

## Diversify the Assets



- Establish collective risk tolerance
- Seek risk-adjusted returns across all markets
- Weigh each investment for its contribution to whole program

## Follow the Law



- Establish and comply with all plan documents
- Be mindful of your role as a sworn public official

QUESTIONS?