

THE FUNDAMENTAL FIDUCIARY DUTIES OF SAN JOSÉ BOARD MEMBERS

1. Exclusive Benefit Rule

“The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.” Cal. Const., art. XVI, § 17(a).

- **Cannot use funds for personal or charitable purposes.** “An abuse of discretion occurs when a trustee acts from an improper even though not dishonest motive, such as when the act is undertaken in good faith but for a purpose other than to further the purposes of the trust or, more specifically, the purposes for which the power was granted.” *O’Neal v. StanCERA Employees’ Retirement Association* (2017) 8 Cal.App.5th 1184, 1209.
- **Conflicts of interest laws are broad.** “The defining characteristic of a prohibited financial interest is whether it has the potential to divide an official’s loyalties and compromise the undivided representation of the public interests the official is charged with protecting. Thus, that the interest might be small or indirect is immaterial so long as it is such as deprives the people of his overriding fidelity to them and places him in the compromising situation where, in the exercise of his official judgment or discretion, he may be influenced by personal considerations rather than the public good.” *Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1075.
- **Trust assets are not political tools.** A fiduciary is prohibited from “subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.” 29 CFR § 2509.2015-01.

2. Primary Loyalty Rule

“The members of the retirement board ... shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board’s duty to its participants and their beneficiaries shall take precedence over any other duty.” Cal. Const., art. XVI, § 17(b).

- **Highest duty of loyalty is owed to plan members.** “The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary. The trustee must not be guided by the interest of any third person. This unwavering duty of complete loyalty to the beneficiary of the trust must be to the exclusion of the interest of all other parties.” *City of Sacramento v. Public Employees’ Retirement System* (1994) 229 Cal.App.3d 1470, 1494.

- **Must timely pay all amounts owed to members, deal fairly with members and fully inform members of their rights.** “We believe that courts must be vigilant in protecting the rights of the pensioner against powerful and distant administrators; the relationship should be one in which the administrator exercises toward the pensioner a fiduciary duty of good faith and fair dealing. *Hittle v. Santa Barbara County Employees’ Retirement Association* (1985) 39 Cal.3d 374, 393.
- **Must reasonably investigate benefit eligibility.** The Board “cannot fill [its] mandate unless it investigates applications and pays benefits only to those members [and beneficiaries] who are eligible for them.” *McIntyre v. Santa Barbara County Employees’ Ret. Sys.* (2001) 91 Cal.App.4th 730, 734.
- **May not pay unauthorized amounts to members:** “While pension provisions should be broadly construed in favor of those who were intended to be benefited thereby, they cannot be construed so as to confer benefits on persons not entitled thereto.” *Duarte v. State Teachers’ Retirement System* (2014) 232 Cal.App.4th 370, 385.
- **Funding of vested benefits must be actuarially sound.** “Actuarial soundness of the system is necessarily implied in the total contractual commitment, because a contrary conclusion would lead to express impairment of employees’ pension rights.” *Board of Administration v. Wilson* (1997) 52 Cal.App.4th 1109, 1133.
- **Discretionary acts must be prudent and in the members’ interests.** “While it is true that the board acts under a grant of plenary authority to administer the retirement system, this grant of discretion is not absolute. ... [Even if] a trust instrument confers ‘absolute,’ ‘sole,’ or ‘uncontrolled’ discretion on a trustee, the trustee shall act in accordance with fiduciary principles and shall not act in bad faith or in disregard of the purposes of the trust.” *O’Neal v. StanCERA Employees’ Retirement Association* (2017) 8 Cal.App.5th 1184, 1215-16.
- **Divergent interests among members should be balanced.** “The pension of a member who loses his job will be dramatically affected by that job loss. Thus, a member’s interest as an employee is clearly related to his interest as a pension beneficiary.” *Bandt v. Board of Retirement* (2006) 136 Cal.App.4th 140, 159.

3. Prudent Person Rule/Duty to Diversify Investments

“The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. ... [They] shall diversify the investments of the system so as to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.” Cal. Const., art. XVI, § 17(c)(d).

- Education and training are necessary to meet the standard
- Delegation may be required when the Board lacks expertise
- Delegation must be prudent and monitored for effectiveness
- The Board is not a rubber stamp for its staff and consultants
- Input and debate from stake holders should be encouraged
- Closed sessions must be limited, meaningful and candid and each member must respect the Board’s confidentiality

**THE LAWS, RULES, REGULATIONS AND POLICIES THAT IMPACT
THE FIDUCIARY DUTIES OF SAN JOSÉ BOARD MEMBERS**

- CALIFORNIA CONSTITUTION, ART. XVI, § 17
- SAN JOSÉ CHARTER, MUNICIPAL CODE AND POLICIES
- POLITICAL REFORM ACT AND RELATED FPPC RULES AND REGULATIONS
- CALIFORNIA GOVERNMENT CODE SECTIONS 6250, ET SEQ. (PUBLIC RECORDS)
- CALIFORNIA GOVERNMENT CODE SECTIONS 54950, ET SEQ. (OPEN MEETINGS)
- CALIFORNIA GOVERNMENT CODE SECTIONS 7501, ET SEQ.
- CALIFORNIA GOVERNMENT CODE SECTIONS 1090, ET. SEQ.
- CALIFORNIA LABOR CODE
- INTERNAL REVENUE CODE AND RELATED IRS RULES AND REGULATIONS
- SECURITIES EXCHANGE ACTS AND RELATED SEC RULES AND REGULATIONS
- BOARD CHARTERS AND POLICIES