

Fiduciary Duties in the Public Sector

Fiduciaries of governmental benefit plans may need to consult a variety of sources to glean the scope of their fiduciary duties and determine which duties can be delegated.



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by | **P. Brian Bartels** and **John E. Schembari**

Fiduciaries of governmental plans confront a unique challenge in determining their duties. Unlike their private sector counterparts, fiduciaries of governmental plans are not directly subject to the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA).¹

Instead, fiduciaries of governmental plans must consult a variety of sources to determine their fiduciary duties, including state constitutions, state statutes, the common law, plan documents, codes of conduct and, by analogy, ERISA and its interpretive cases.

This article is intended to assist governmental plan fiduciaries by providing a general overview of the definition of *fiduciary*, the sources of their fiduciary duties, the general duties applicable to fiduciaries of governmental plans, issues to consider when delegating fiduciary duties and co-fiduciary liability. It also identifies best practices to help governmental plan fiduciaries fulfill their duties and avoid liability.

Meaning of *Fiduciary*

Before discussing the source and scope of fiduciary duties owed to governmental plans, it is necessary to identify the persons who are fiduciaries with respect to such plans. In general, a *fiduciary* is a “person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor . . .”² Although ERISA fiduciary responsibility provisions do not apply to governmental plans, its definition of fiduciary is instructive. Under ERISA, a person is a fiduciary (1) to the extent he or she exercises any discretionary authority or control respecting the management of a plan or management or disposition of its assets; (2) to the extent he or she renders investment advice for a fee or has authority or responsibility to do so; or (3) if he or she possesses any discretionary authority or responsibility in administering a plan.³ Depending on state law, individuals could be considered fiduciaries

with respect to a governmental plan by performing the type of actions specified in ERISA.

State laws may define or identify the persons who are fiduciaries with respect to a governmental plan. For example, the Illinois Pension Code defines the persons who are fiduciaries with respect to certain retirement systems or pension funds.⁴ The Illinois Pension Code defines fiduciary in a manner similar to ERISA, making it relatively straightforward to determine whether a person is a fiduciary with respect to an Illinois public retirement system or pension fund.⁵

Nebraska law also identifies the individuals who are fiduciaries of certain public retirement systems. Under the Nebraska State Funds Investment Act, the appointed members of the Nebraska Investment Council are fiduciaries with respect to the investment of the assets of the retirement systems the Public Employees Retirement Board administers.⁶ Similarly, the appointed members of the Nebraska Public Employees Retirement Board are fiduciaries with respect to the administration of certain retirement systems for judges, county

employees, the Nebraska State Patrol, school employees and state employees.⁷

State laws vary in the manner in which they define or identify the individuals who are fiduciaries of governmental plans, so it is important for individuals to survey applicable state laws to help ensure they do not inadvertently take actions, or accept a position, that would render them a fiduciary with respect to a plan.

In addition to state statutes, the applicable plan documents may identify the individuals who are fiduciaries with respect to a plan. For example, the plan document may state that the trustee, investment manager and plan administrator are fiduciaries. Accordingly, individuals should consult the plan documents to determine whether they are considered a fiduciary.

Sources of Fiduciary Duties

ERISA fiduciary responsibility provisions do not apply to fiduciaries of governmental plans, so such fiduciaries must consult other sources of law to determine the duties owed to their plans.⁸ Depending on the state in which a plan is established or administered, sources

such as the state constitution, state statutes and judicial opinions, as well as the plan documents, may establish or enumerate fiduciary duties.

State constitutions are one source of fiduciary duties for governmental plans. For example, under the New Hampshire Constitution, all assets, proceeds and income of the New Hampshire retirement system must be held, invested and disbursed “as in trust for the exclusive purpose” of providing retirement and related benefits and “shall not be encumbered for, or diverted to, any other purposes.”⁹ The California Constitution extensively enumerates fiduciary duties for the retirement board of a state public pension or retirement system.¹⁰ The extent to which state constitutions enumerate fiduciary duties for governmental plans varies greatly, so individuals serving as fiduciaries of governmental plans should carefully review the applicable state constitution to determine their fiduciary duties.

State statutes also establish fiduciary duties for governmental plans. State statutes may specify assorted duties, such as those relating to reporting and record-keeping, allocating plan expenses and training for fiduciaries or trustees.¹¹ State statutes may also require fiduciaries to act solely in the interest of participants and beneficiaries.¹² Judicial opinions may interpret federal and state constitutions and statutes and determine the fiduciary duties owed to governmental plans. Judicial opinions routinely analogize to ERISA to determine the duties fiduciaries owe to governmental plans, making ERISA an indirect source of fiduciary duties.¹³ Additionally, the common law of trusts may provide guidance on fiduciary duties in the absence of specific legislation.¹⁴

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Plan documents are another potential source of fiduciary duties for governmental plans. The plan documents may provide details regarding holding, administering and investing plan assets; funding requirements; hiring outside experts; plan governance and administration; and contracting. Governmental plans may also include a code of conduct. Codes of conduct typically address ethics; conflicts of interest; disclosure of fees, gifts and campaign contributions; the use of placement agents; and insider trading issues. Accordingly, individuals serving as fiduciaries of governmental plans should carefully review all applicable plan documents and any codes of conduct to help determine their fiduciary duties.

Governmental Plan Fiduciary Duties

The specific fiduciary duties owed to a particular governmental plan depend, in part, on the applicable state constitution, statutes, common law and plan documents. Although the exact fiduciary duties are dependent on applicable law and the plan documents, several general fiduciary duties apply to virtually all governmental plans. Fiduciaries of governmental plans possess a duty of loyalty and duty of prudence.¹⁵

The *duty of loyalty* requires a fiduciary to administer a plan solely in the interest of participants and beneficiaries. The duty of loyalty also prohibits a fiduciary from engaging in self-dealing. In applying the duty of loyalty, fiduciaries must deal with participants fairly and communicate all material facts to participants.¹⁶

The *duty of prudence* addresses the manner in which fiduciaries carry out their duties. Fiduciaries must follow the terms of the plan documents, to the extent such terms are consistent with applicable law.¹⁷ Fiduciaries must administer the plan as a prudent person would under similar circumstances. The duty of prudence requires fiduciaries to exercise reasonable skill, care and caution in carrying out their responsibilities. If a fiduciary possesses special skills, he or she must use such skills to administer the plan.¹⁸

As previously discussed, state constitutions and statutes may detail specific duties fiduciaries owe to governmental plans. The California Constitution provides one example of a state constitution that enumerates fiduciary duties. The California Constitution provides that public pension or retirement system assets must 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.”¹⁹ Additionally, members of the retirement board must:

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- ERISA doesn't cover fiduciaries of public employee benefit plans, although ERISA spells out some actions that, if performed, make a person a fiduciary under some states' laws.
- State laws vary; individuals considering taking an action or accepting a position with a public plan should review state laws and plan documents to avoid inadvertently becoming a plan fiduciary.
- Several general fiduciary duties apply to virtually all governmental plans, including a duty of loyalty and a duty of prudence.
- State statutes often establish fiduciary duties for public retirement systems.
- Fiduciaries may be allowed to delegate some duties but should first consult the plan document and state and federal law.
- Permitting a co-fiduciary to commit a breach is itself a breach of a fiduciary duty.

(D)ischarge 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.²⁰

Similar to ERISA, the California Constitution provides that members of the retirement board must “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.”²¹ The California Constitution also mandates that members of the retirement board “diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.”²²

State statutes often establish fiduciary duties for public retirement systems. For example, under Texas law, when making and supervising investments of certain public retirement system funds, investment managers must discharge their duties solely in the interest of participants and beneficiaries.²³ Additionally, the investment managers must discharge their duties for the exclusive purpose of providing benefits and defraying the reasonable administration expenses of the retirement system.²⁴ The investment managers must also discharge their du-

ties with the “care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise with a like character and like aims”²⁵ Investment managers are required to diversify investments when it is prudent to do so and discharge their duties in accordance with the governing plan documents.²⁶

Delegating Fiduciary Duties

Under certain circumstances, it may be prudent for fiduciaries to delegate their duties to others. The common law of trusts informs governmental plan fiduciaries of the duties that may be delegated. Under the common law of trusts, a trustee has a general duty to perform his or her responsibilities personally.²⁷ However, a trustee is permitted to delegate his or her duties if a prudent person would delegate such duties.²⁸ A plan document may permit,

direct or restrict delegation.²⁹ Common examples of duties governmental plan fiduciaries delegate include investment selection and investment management.

Fiduciaries must act prudently when delegating their duties.³⁰ Prior to delegating a duty, a fiduciary should consult the plan document as well as state and federal law. Fiduciaries must determine whether it is prudent to delegate by considering a variety of factors, such as to whom a duty should be delegated and the manner in which the delegation should be made. The decision-making process for determining whether to delegate a particular duty should be documented. Once the decision to delegate a duty has been made and documented, fiduciaries must negotiate and establish the terms of the delegation. Among other things, the terms of the delegation should include a description of the matters being delegated, instructions to the delegate, the delegate’s compensation, the term of the delegation, reporting re-

quirements and consent to the jurisdiction of specific courts.

After delegating duties, fiduciaries have an ongoing responsibility to monitor and supervise delegates.³¹ If a fiduciary delegates fiduciary duties, then the delegate is an agent of the fiduciary. As an agent, the delegate has fiduciary duties, including acting with reasonable care and complying with the terms of the delegation. Fiduciaries must act as a prudent person would under similar circumstances to monitor and supervise the delegate’s performance.³² Fiduciaries must also take steps to remedy a delegate’s breaches.³³

Co-Fiduciaries and Fiduciary Liability

Governmental plans typically have more than one fiduciary, so it is critical for fiduciaries to understand their co-fiduciary duties and liabilities. As a general rule, fiduciary duties apply to each fiduciary. Each fiduciary has a duty and right to participate in the administration of a plan.³⁴ However, a plan document may provide different requirements for co-fiduciaries by allocating, modifying or limiting a fiduciary’s roles, responsibilities or duties.³⁵ In addition to the duties previously discussed, each fiduciary has a duty to use reasonable care to prevent a co-fiduciary from committing a breach.³⁶ Importantly, permitting a co-fiduciary to commit a breach is itself a breach of a fiduciary duty. A fiduciary who learns that another fiduciary has breached his or her duties must take reasonable steps to compel the breaching fiduciary to redress the breach.³⁷

A fiduciary may be liable for a co-fiduciary’s breach under certain cir-

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cumstances³⁸—for example, if the fiduciary participated in, acquiesced to or helped conceal the breach. A fiduciary can also be liable for a co-fiduciary’s breach if the fiduciary improperly delegated duties to a co-fiduciary. Additionally, a fiduciary may be liable for a co-fiduciary’s breach if the fiduciary’s failure to exercise reasonable care enabled the co-fiduciary to breach his or her duties or the fiduciary fails to seek redress of a breach.³⁹


Conclusion and Recommendations

Fiduciaries of governmental plans confront a unique challenge in determining their specific fiduciary duties. Because the fiduciary responsibility provisions of ERISA do not apply to governmental plans, fiduciaries must examine a variety of sources, such as state constitutions, statutes, common law, plan documents and codes of conduct, to determine their fiduciary duties. Typical fiduciary duties include the duty of loyalty and duty of prudence. Under certain circumstances, fiduciaries may be able to delegate fiduciary duties to others. If fiduciaries delegate any of their fiduciary duties, they must act prudently in making the delegation, monitor and supervise the delegate, and document their actions. When a plan has more than one fiduciary, each fiduciary must monitor the other fiduciaries and take reasonable steps to address any fiduciary breaches. Failing to properly monitor a co-fiduciary or redress a co-fiduciary’s breach may result in a fiduciary being liable for the co-fiduciary’s breach.

To help protect themselves from potential liability, fiduciaries should adopt and follow best practices. For example, working with legal counsel, fiduciaries can develop and adopt fiduciary handbooks that educate and train fiduciaries on the applicable law and duties they owe to a governmental plan. Fiduciaries should:

- Hold regular meetings to review and address plan-related issues.
- Establish policies and procedures to monitor co-fiduciaries, delegates and service providers and address any breaches.
- Document decision-making processes.
- Similarly, document the actions they take to monitor delegates and service providers and address any performance issues.
- Establish and follow a conflicts-of-interest policy and document compliance with it.

Implementing these procedures in consultation with legal

counsel can help fiduciaries guard against breaches of fiduciary duties and the attendant liability. 

Endnotes

1. Employee Retirement Income Security Act of 1974, as amended (ERISA) §§4(b)(1) and 401(a) (West 2014).
2. *Black’s Law Dictionary* 658 (8th ed. 2004).
3. ERISA §3(21).
4. 40 Illinois Compiled Statutes Annotated. 5/1-101.2 (West 2014).
5. “A person is a ‘fiduciary’ with respect to a pension fund or retirement system established under this Code to the extent that the person: (1) exercises any discretionary authority or discretionary control respecting management of the pension fund or retirement system, or exercises any authority or control respecting management or disposition of its assets; (2) renders investment advice or renders advice on the selection of fiduciaries for a fee or other compensation, direct or indirect, with respect to any moneys or other property of the pension fund or retirement system, or has any authority or responsibility to do so; or (3) has any discretionary authority or discretionary responsibility in the administration of the pension fund or retirement system.” 40 Illinois Compiled Statutes Annotated. 5/1-101.2.
6. Nebraska Revised Statutes §72-1239.01(1)(a) (West 2014).
7. Nebraska Revised Statutes §§84-1503.02(1), 84-1503(1)(a) (West 2014).
8. ERISA §§4(b)(1) and 401(a).
9. New Hampshire Constitution Article 36-a.
10. See California Constitution Article 16, §17.
11. See, e.g., Louisiana Revised Statutes Annotated §11:185 (West 2014); West Virginia Code Annotated. §8-22-18a (West 2014).
12. See, e.g., Nebraska Revised Statutes §84-1503.02(2).
13. See, e.g., *Honda v. Board of Trustees of the Employees’ Retirement System of the State of Hawai’i*, 108 Haw. 338, 347 (2005) (analogizing to ERISA’s requirement that summary plan descriptions must not mislead, misinform or fail to inform participants and beneficiaries); *Canady v. Washington Metropolitan Area Transit Authority*, 909 F. Supp. 324, 327, 329 (D.Md. 1995) (referencing case law interpreting ERISA to identify the standard of review applicable to the decision of a governmental plan’s trustees’ decision to deny a claim for benefits).
14. See, e.g., *Sharma v. Washington Metropolitan Area Transit Authority*, Civ. No. 03-1768 (TFH), 2014 WL 3512866, at *9 (D.D.C. July 17, 2014) (in a case involving a governmental plan, in the absence of statutory and case law, the court applied the common law of trusts (as expressed in the Restatement (Second) of Trusts)).
15. See, e.g., Restatement (Second) of Trusts §170, 174 (1959).
16. See id. §170; Restatement (Third) of Trusts §78 (2007).
17. Restatement (Third) of Trusts §76(1).
18. See Restatement (Second) of Trusts §174; Restatement (Third) of Trusts §77.
19. California Constitution Article 16, §17.
20. Id.
21. Id.; ERISA §404(a)(1)(B).
22. California Constitution Article 16, §17.
23. Texas Government Code §802.203 (West 2014).
24. Id.
25. Id.
26. Id.
27. Restatement (Second) of Trusts §171, 171 cmt. a.; Restatement (Third) of Trusts §80(1).
28. See Restatement (Third) of Trusts §80(1), 80 cmt. d.
29. See Restatement (Second) of Trusts §171 cmt. j.
30. See Restatement (Third) of Trusts §80 cmt. d(2).
31. Restatement (Second) of Trusts §171 cmt. k.
32. Restatement (Third) of Trusts §80.
33. Id. §80 cmt. d(2).
34. See Restatement (Second) of Trusts §184; Restatement (Third) of Trusts §81(1).
35. Restatement (Second) of Trusts §184 cmt. b.
36. Restatement (Third) of Trusts §81(2).
37. Restatement (Third) of Trusts §81 cmt. d.
38. Restatement (Second) of Trusts §224(2).
39. Restatement (Third) of Trusts §81cmt. e.