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Commentary: Public pension fund trustees must master 3 tough tasks

Tony Gelderman

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Public pension fund trustees' stewardship and governing role requires knowing exactly what it means to be a fiduciary.

Serving as a trustee of a public pension fund is an honor, but the role is a demanding one. Public pension fund trustees' stewardship and governing role requires knowing exactly what it means to be a fiduciary. And there is no fiduciary relationship more complete and absolute as that between public pension fund trustees and their beneficiaries. They must act legally and ethically in their beneficiaries' best interests, discharging their duties in the exclusive interest of the beneficiaries of the fund. They must act in all matters with the qualities of loyalty, prudence, skill, care and diligence. These requirements may be summarized in three duties: the duty to delegate, the duty to use care and the duty of diligence.

The duty to delegate

Trustees should know what they do not know. For example, few if any boards of trustees will have the necessary expertise to manage their funds' investments, perform actuarial calculations, manage information technology systems or implement cybersecurity measures to protect the fund's data and assets from hackers. Since fund trustees cannot know and learn everything about the matters they supervise, they must delegate. They must employ highly skilled professionals to handle technical tasks that require special expertise and experience and allow those professionals the power to discharge those responsibilities effectively. They should hire external experts and professionals without choosing solely on the basis of expense, and they should set reasonable and appropriate salaries for internal staff. Quality of the talent to whom duties are delegated matters, and hiring and retaining a qualified team is a challenge. But in order to avoid liability, trustees must spend the time and money to find the right fit. They must also specify the scope of the delegation and monitor their agents' actions to be certain the work is carried out competently and in their beneficiaries' best interests.

The duty of care

As fiduciaries, trustees must also use care, i.e., "watchful attention," in discharging their duties. For instance, they must maintain the fund with up-to-date investments and ensure the fund is financially secure. They must minimize the risk of loss, particularly by diversifying investments through asset allocation, unless such diversification is clearly imprudent. In short, they must keep an ever-watchful eye over the fund's performance and its future prospects. They cannot afford to allow their stewardship to create anything less than the highest possible results within the fund's guidelines.

The duty of diligence

Trustees must exercise diligence. This requires an overall commitment of time and effort to their responsibilities, but there are obvious and definite tasks that are mandatory. This list is not comprehensive but instructive, and it is intended to provide a baseline on which trustees may build:

- They must have read and familiarized themselves with the statutes, internal policies (including ethics policies) and mission statements for the plan.
- They should read the past three annual reports and audit reports of the plan.
- They should ask the fund's investment officer to explain the fund's current asset allocation.
- They should establish a working knowledge of their state's open records, open meetings and ethics laws.
- They must prepare studiously for, and attend, all meetings, except in extraordinary personal circumstances.
- At meetings, they must engage by asking questions and candidly expressing views on the subjects discussed.
- They should network with other trustees to learn their experience and skills to develop a board culture conducive to working together to fulfill their duties to the fund and its beneficiaries.
- They should, where appropriate, obtain advice from outside experts.

Why should trustees take these duties and their overall performance as custodians of the fund to heart? Obviously, it is critical to the health of the fund that there be involvement and supervision by those who have the beneficiaries' interests as primary, but trustees must also adhere to these standards because failure to do so carries significant risks. Breach of fiduciary duty may result in personal liability for making good on losses occurring from that breach. A breach of duty occurs when the fiduciary acts in his or her own interest and advantage rather than that of the fund beneficiaries. And it is the duty of the trustee to make sure the other trustees do not breach their duty. In the trustee world, a trustee is his brother's keeper. A fiduciary who participates in a breach committed by a co-fiduciary, or who tries to conceal or fails to expose a co-fiduciary's breach, can be held jointly liable for that breach. Failure to exercise the duty of care in overseeing co-fiduciaries to prevent a breach also potentially creates liability. A trustee must play his or her role as a part of a whole, and must keep in mind that interdependency at all times.

One of the most important ways that trustees may act to avoid a breach and the resulting liability is to establish appropriate processes and procedures. Since it is impossible to monitor every agent and consultant to whom responsibilities are delegated, the board must establish standards and protocols that the fund, its agents and its consultants employ when conducting due diligence reviews of asset managers, investment advisers and other service providers. Trustees should focus on setting the long-term strategic direction for the plan, and on establishing performance measurements for key internal operations and external contractors. The mantra should be process, process, process. And although trustees must have a great deal of knowledge about the fund and how it is run, these procedures are the way that they can oversee without having to micromanage. The board should steer, not row, the boat.

Notwithstanding the technical requirements of their fiduciary duties, trustees should never discount common sense in decision-making. For instance, if a deal looks too good to be true, it often is. Trustees must remember they are acting in a public fiduciary capacity, and employ the "front-page test", i.e., would they be comfortable with the action they are taking being described on the front page of the local newspaper. A negative answer means the trustees should rethink the course of action.

The best summary of the trustees' duties in managing a public pension fund is that they must both individually and as a board embrace excellence. The fund beneficiaries deserve it, and fiduciary obligation requires it.

Tony Gelderman is an attorney at Bernstein Litowitz Berger & Grossmann LLP, New Orleans. This content represents the views of the author. It was submitted and edited under Pensions & Investments guidelines, but is not a product of P&I's editorial team.

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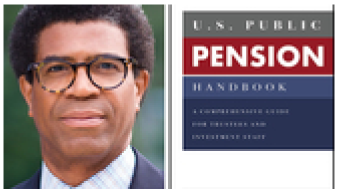

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