



# **ANCHORAGE POLICE AND FIRE RETIREMENT SYSTEM**

**March 31, 2022**

FIDUCIARY EDUCATION – CONSIDERATIONS FOR  
CLOSED PLANS WITH A MATURE POPULATION

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## **I. FIDUCIARY DUTY - A REFRESHER**

### **A. Fiduciary Defined.**

1. A person is a fiduciary with respect to an employee benefit plan to the extent he/she exercises discretionary authority with respect to plan and assets.
2. Exercise of discretion is the key.
3. Can include more than just the trustees.
4. Extends to investment management and benefit administration.

B. Judicial Standards.

1. **Meinhard v. Salmon**, 164 NE 545 (N.Y. Ct.App. 1928).

Court determines that common standard of the marketplace is unacceptable to fiduciaries. General trust standard was expanded for pension trustees to include a definition of "undivided loyalty" to be applied with "uncompromising rigidity."

2. **NLRB v. Amax Coal Co.**, 453 U.S. 322 (1981).

U.S. Supreme Court holds that plan trustees have an "unwavering duty of complete loyalty" to members and beneficiaries. Trustees cannot serve any master other than the fund. The pressures of undivided loyalty are inconsistent with the give and take of collective bargaining.

## II. **INVESTMENT ISSUES**

A. Due Diligence.

There are important factors to take into account in obtaining investment opportunities for the Retirement Plan. It must be remembered that the Trustees act as the fiduciary on behalf of the members and beneficiaries of the Retirement Plan. All assets of the Retirement Plan must be used for the exclusive use and benefit of the members and beneficiaries and for defraying the reasonable cost of Plan administration. Prior to entering into any investment contract it is essential that due diligence be performed regarding the safety and security of the investment and its appropriateness for the Retirement Plan. The following checklist is recommended:

1. If the Plan is responsible for management of its own assets, this procedure should be followed.

2. The Plan should have a written investment policy setting forth the nature of permitted investments (stocks, bonds, real estate, etc.).
3. The investment policy should set forth the percentage of assets which may be placed in any one investment category, as well as the quality rating attributable to those securities (for example, government securities, investment grade securities, etc.)
4. The investment policy should set forth standards for performance for the investment managers.
5. There should be written contracts between the Plan and the investment manager setting forth the expected standard of performance of the investment managers, liability for failure to perform, fiduciary responsibility standard of the managers in a dispute resolution process.
6. The Plan should retain the services of an independent performance monitor to compare the performance of Plan assets against other standardized investment indices (for example, S&P 500, Russell 2000, etc.). Investment manager reports should be received not less than quarterly. Indexing companies will often provide custom indexes to funds at no cost.
7. Performance monitor reports should be received not less than yearly. If the Plan is a defined benefit plan, the services of an enrolled actuary should be secured.
8. An actuarial valuation should be done at least every three years.
9. An experience study to test the accuracy of the actuarial assumptions utilized should be performed at least every five years.

10. The Plan should have an annual audit performed by a certified public accountant independent of the Plan sponsor. The accountant should also provide a management letter setting forth any observations concerning efficiency and security of Plan operations.
11. If the Plan is managed by a board of trustees, errors and omissions insurance may be secured.
12. The Plan should be represented by independent legal counsel.
13. Providers of service to the Plan should have written contracts setting forth duties, compensation, fiduciary obligations and a dispute resolution procedure.
14. An annual report should be made available to the members and the Plan sponsor setting forth the annual performance.

B. Prudent Investor Rule.

The prudent investor rule is a general standard of trust law which requires investors to exercise a reasonable and prudent standard of care. It compares the behavior of a fiduciary to the expected standard of behavior of other similarly situated persons responsible for the investment of monies belonging to others. Many states have adopted statutory standards for fiduciary duty of investment professionals handling pension assets. While the rule is not codified under every state, general trust principles will apply.

C. Reliance on Reports From Financial Advisors.

It is extremely important that financial reports simply not be taken at face value without review and explanation. If the fiduciaries do not understand each investment opportunity in which the Plan is engaged, it is likely that it is not prudent to be so invested. Recent federal decisions held trustees in a private sector plan personally responsible for plan losses attributable to their failure to question and understand the appropriateness of an investment for the plan. In that case,

the trustees blindly accepted the performance report of the investment manager when it in fact was a substandard and inappropriate investment. The use of a performance monitor is the best protection against failing to apply prudent investor standards to the performance of the plan. In addition, it is advisable to pay an on-site visit to each prospective investment manager to ensure that their operation in fact is reflective of their promotional material. All promotional material should be retained for comparative purposes against the actual performance received. All contracts with investment managers should be terminable without cause and without notice so that prompt action may be taken with regard to an underperforming investment manager. Investment contracts should also provide that if the manager procures an inappropriate investment for the plan which results in a loss that the investment manager shall be responsible for making whole any loss incurred.

Retirement funds have a fiduciary to protect the interest of their members. Most public retirement plans incorporate the prudent investor standard from the Employee Retirement Income Security Act of 1974 (ERISA) (26 United States Code, Section 1104). While ERISA does not apply to plans maintained by state or local government entities, the ERISA standard of acting as a prudent investor has been adopted. Armed with the knowledge that a mutual fund, or any investment professional, has compromised the integrity of the retirement fund, the Board of Trustees has a duty to act and replace the manager.

D. What can an institutional investor do to protect itself?

There are a number of steps in light of the recent revelations of Wall Street misconduct that institutional investors can do to protect themselves:

1. Ask all investment managers for a statement of their compliance policies with SEC rules.
2. Direct communication with managers, beginning with the selection process.

3. Adding contractual penalties for SEC rule violations.
4. Require immediate notice of any SEC or other investigation of company trading practices.
5. Provide for return of fees in instances of fraud or breach of contract.
6. Adopt investigatory policies as part of the investment policy.
7. Remain current on news issues.
8. Trustee education.
9. Taking an active role in securities litigation class actions as outlined above.

E. The Alaska Uniform Prudent Investor Act.

1. Alaska has adopted the Uniform Prudent Investor Act which relates to the standards applicable for fiduciaries of public or private trusts.
2. A.S. 13.65.010 establishes the standard of conduct, adopting the common law prudent person standard and applying it to modern portfolio theory for the prudent institutional investor as reflected in the Restatement of Trusts.
3. Generally, the law requires the institutional investor to take into account the following factors:
  - a. General economic conditions;
  - b. Effects of inflation or deflation;
  - c. Expected tax consequences of a transaction (UBIT, for example);
  - d. The role of a particular investment in the overall investment portfolio;
  - e. Expected total return;
  - f. Other resources of the Fund; and

- g. The need to make distributions and preserve capital.
- 4. Investments are not to be viewed in isolation but in relationship to the total portfolio and the risk and return objectives.
- 5. The Fund has unrestricted investment authority under state law, subject to the AMC and the Board's own investment policy.
- 6. Diversification is required unless it is plainly unreasonable to do so in light of specific circumstances.
- 7. Property received must be conformed to the Fund's investment policy within a commercially reasonable time.
- 8. Any trustee with special knowledge or skills is expected to employ them for the benefit of the Fund (prudent *expert* rule).
- 9. A.S. 13.65.030 permits delegation of investment functions provided that due diligence is employed in the selection and monitoring of an agent. Any asset manager or consultant accepting the assignment consents to jurisdiction of the state court in all matters relating to the work. Further, the agent owes a reasonable duty of care in the performance of its work. If the Board uses due diligence in the selection and monitoring of investment advisors, it is entitled to rely on their actions and advice.
- 10. A.S. 13.65.050 provides that compliance with the law is based on the circumstances and knowledge at the time a decision was made; not in hindsight.
- 11. A.S. 13.65.070 provides that AMC 3.85 will control in case of a conflict with the state law.
- 12. A.S. 13.65.080 provides that because this is a uniform law, the case decisions in other jurisdictions of this

same law must be given consideration to insure national uniformity in interpretation and application.

F. Crypto or No Crypto?

1. On March 10, 2022, the U.S. Department of Labor issued Compliance Assistance Release No. 2022-01 relating to the responsibility of fiduciaries who invest in crypto currency.
2. The DOL issued the following concerns:
  - a. Cryptocurrency is a speculative and volatile investment
  - b. It's a challenge for plan participants to make informed investment decisions about cryptocurrency
  - c. There are custodial and record-keeping concerns as well as valuation concerns. Cryptocurrency is not held in traditional custodial accounts. They exist as lines of computer code in a digital "wallet." The lines are vulnerable to hacking and may even be lost by simply losing a password.
  - d. The regulatory environment is still evolving
3. While the DOL does not regulate governmental plans such as APFRS, its observations and expressions of fiduciary concerns would likely be reviewed as indicia of fiduciary duty in any claim.
4. The law concerning investment decision making has been evolving
  - a. ***Tibble v. Edison International***, 577 U.S. 523 - Applies common law of trusts to ERISA plans and finds that under general trust law principles a fiduciary has a continuing duty to monitor



investment offerings to participants and to remove imprudent ones.

- b. ***Thole v. U.S. Bank***, 140 S.Ct. 1615 (2020) - By comparison to participants in Tibble case, Thole plaintiffs were in a defined benefit plan. Imprudent investments place the burden on the plan sponsor and not the participants; therefore they lack standing to sue. This is consistent with the results in a recent Kentucky Supreme Court case, *Overstreet v. Mayberry*, 603 S.W. 3d 244 (Ky. 2020) which dismissed a suit by members challenging the use of hedge funds in the state retirement plan.
  
- c. ***Hughes v. Northwestern University***, 142 S.Ct. 737 (2022) - In a case decided in January 2022, the U.S. Supreme Court further increased a basis for liability in self-directed plans. The Court found that plan administrators violated their fiduciary duty by offering too many choices that led to participant confusion and poor decision making. And reiterated a continuing duty to monitor record keeping fees and failing to offer institutional products that had lower management fees than the identical retail products that were offered.
  
- d. ***Overstreet v. Mayberry***, 603 S.W. 3d 244 (Ky. 2020) – A group of active and retired members of the Kentucky Retirement Systems filed suit against certain board members and service providers claiming they knowingly invested in hedge funds which were not authorized by law and which resulted in material losses to the plan. Ultimately the Kentucky Supreme Court held that the participants lacked standing to bring suit because in a defined benefit plan the members own a contract for a specific benefit unrelated to the assets. This is a slightly different view than that expressed in *Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997) where the

Supreme Court of Alaska held that assets allocated to a specific plan with the APFRS could not be used to the benefit of any other plan within the System. What is commonly held between the cases is that the existence of additional assets does not increase benefits.

### **III. SPECIAL CONSIDERATIONS FOR CLOSED DEFINED BENEFIT PLANS**

#### **A. Considerable Debate Among Think-Tanks.**

Various pension centered think-tanks have differing views concerning the changes required investment risk parameters for closed defined benefit plans. Compare studies by Reason Foundation and The National Institute for Retirement Security (NIRS).

The Reason Foundation has expressed the belief that closed plans lead to removing investment risk but re-opening them introduces the chance for more debt. The Reason Foundation model emphasizes risk sharing rather than the traditional defined benefit model of the plan sponsor receiving both the risk and the reward.

The NIRS studies show that closing DB plans did not improve funding and led to greater retirement insecurity. The absence of DB plans has created impediments to recruiting and retention.

#### **B. At least one federal court permitted an ERISA case to move forward concerning a closed retirement plan based on the assertion that the investment of plan assets was not altered even when it was clearly imprudent to follow that course of action.**

***Sims v. First Horizon Nat'l Corp.***, 2009 WL 3241689 (W.D. Tenn. 2009)

C. Florida Courts Place Full Cost of Depleted Plan on Plan Sponsor.

Following the merger of a small town fire department with a larger country-wide fire service, the town closed its defined benefit firefighters pension plan. Under the plan design, members could elect a present value cash distribution. The three most senior members of the plan elected this option and completely depleted plan assets. The town attempted to disclaim any responsibility for the benefits earned by the remaining plan members. The Pension Board sued for the additional contributions and the trial court ruled against the Board. On appeal, the decision was reversed finding that the ultimate responsibility to maintain the plan was the obligation of the plan sponsor.

***Board of Trustees v. Town of Lake Park***, 996 So.2d 446 (Fla. 4<sup>th</sup> DCA 2007)

But, a federal appeals court reached a contrary conclusion concerning a police pension plan in North Carolina. The plan document provided benefits were dependent on available assets. When the plan became insolvent, retirees and members sued the city. Ultimately ruling for the City, the federal appeals court found the constitutionally protected pension contract was fulfilled because what members got was exactly what they bargained for - a plan dependent on available assets.

***Crosby v. City of Gastonia***, 635 F.3d 634 (4<sup>th</sup> Cir. 2011)

#### **IV. SPECIAL ISSUES FOR AGING MEMBERSHIP**

- A. Diminished Capacity
- B. Durable Power of Attorney

This means the power of attorney is not terminated by the principal's incapacity. AS § 13.06.050 (14) and (40); §13.26.675.

§13.26.665(h) applies to retirement benefits

Statutory form AS § 13.26.645. Authority to make retirement plan decisions should be specific.

C. Indicia of Fraud

D. AS § 13.12.804

Divorce revokes beneficiary designations unless otherwise provided by court order or plan documents. Creates a presumption of revocation.

E. Who is a surviving spouse?