

DAVID C. MATTAX
CHIEF, FINANCIAL LITIGATION DIVISION
OFFICE OF THE ATTORNEY GENERAL OF TEXAS¹

DISCLOSURE REQUIREMENTS FOR
TRUSTEES OF PUBLIC PENSION PLANS

TEXPERS
2009 Summer Educational Forum

¹ The views expressed in this paper are solely those of the author and do not necessarily represent the official position of the Office of the Attorney General.

Statutory Disclosure Requirements

GOVERNMENT CODE TITLE 8. PUBLIC RETIREMENT SYSTEMS

SUBTITLE A. PROVISIONS GENERALLY APPLICABLE TO PUBLIC RETIREMENT SYSTEMS

CHAPTER 802. ADMINISTRATIVE REQUIREMENTS

§ 802.103. Annual Financial Report

(a) Except as provided by Subsection (c), **the governing body of a public retirements system shall publish an annual financial report showing the financial condition of the system as of the last day of the fiscal year covered in the report. The report must include the financial statements and schedules examined in the most recent audit performed as required by Section 802.102** and must include a statement of opinion by the certified public accountant as to whether or not the financial statements and schedules are presented fairly and in accordance with generally accepted accounting principles.

§ 802.106. Information to Member or Annuitant

(c) **A public retirement system annually shall provide to each active member a statement of the amounts of the member's accumulated contributions and total accumulated service credit** on which benefits may be based and to each annuitant a statement of the amount of payments made to the annuitant by the system during the preceding 12 months.

(d) **A public retirement system shall provide to each active member and annuitant a summary of the financial condition of the retirement system, if the actuary of the system determines, based on a computation of advanced funding of actuarial costs, that the financing arrangement of the system is adequate.**

§ 802.107. General Provisions Relating to Reports.

(a) **A public retirement system shall maintain for public review at its main office and at such other locations as the retirement system considers appropriate copies of the most recent edition of each type of report or other information required by this chapter to be submitted to the State Pension Review Board.**

LOCAL GOVERNMENT CODE

TITLE 5. MATTERS AFFECTING PUBLIC OFFICERS AND EMPLOYEES

SUBTITLE C. MATTERS AFFECTING PUBLIC OFFICERS AND EMPLOYEES OF MORE THAN ONE TYPE OF LOCAL GOVERNMENT

CHAPTER 176. DISCLOSURE OF CERTAIN RELATIONSHIPS WITH LOCAL GOVERNMENT OFFICERS; PROVIDING PUBLIC ACCESS TO CERTAIN INFORMATION

Sec. 176.001. DEFINITIONS. In this chapter:

(3) **"Local governmental entity" means a county, municipality, school district, charter school, junior college district, or other political subdivision of this state or a local government corporation, board, commission, district, or authority to which a member is appointed by the commissioners court of a county, the mayor of a municipality, or the governing body of a municipality.**

(4) "Local government officer" means:

(A) a member of the governing body of a local governmental entity

Sec. 176.002. APPLICABILITY TO CERTAIN VENDORS AND OTHER PERSONS.

(a) **This chapter applies to a person who:**

(1) **enters or seeks to enter into a contract with a local governmental entity;**

Sec. 176.003. **CONFLICTS DISCLOSURE STATEMENT REQUIRED.**

(a) **A local government officer shall file a conflicts disclosure statement with respect to a person described by Section 176.002(a) if:**

(1) **the person enters into a contract with the local governmental entity or the local governmental entity is considering entering into a contract with the person; and**

(2) **the person:**

(A) **has an employment or other business relationship with the local government officer or a family member of the officer that results in the officer or family member receiving taxable income, other than investment income, that exceeds \$2,500 during the 12-month period preceding the date that the officer becomes aware that:**

(i) **a contract described by Subdivision (1) has been executed; or**

(ii) **the local governmental entity is considering entering into a contract**

with the person; or

(B) has given to the local government officer or a family member of the officer one or more gifts that have an aggregate value of more than \$250 in the 12-month period preceding the date the officer becomes aware that:

(i) a contract described by Subdivision (1) has been executed; or

(ii) the local governmental entity is considering entering into a contract with the person.

(a-1) A local government officer is not required to file a conflicts disclosure statement in relation to a gift accepted by the officer or a family member of the officer if the gift is:

(1) given by a family member of the person accepting the gift;

(2) a political contribution as defined by Title 15, Election Code; or

(3) food, lodging, transportation, or entertainment accepted as a guest.

(b) A local government officer shall file the conflicts disclosure statement with the records administrator of the local governmental entity not later than 5 p.m. on the seventh business day after the date on which the officer becomes aware of the facts that require the filing of the statement under Subsection (a).

(c) A local government officer commits an offense if the officer knowingly violates this section. An offense under this subsection is a Class C misdemeanor.

(d) It is an exception to the application of Subsection (c) that the person filed the required conflicts disclosure statement not later than the seventh business day after the date the person received notice from the local governmental entity of the alleged violation.

Statutory Requirements for Fiduciaries

GOVERNMENT CODE TITLE 8.
PUBLIC RETIREMENT SYSTEMS

SUBTITLE A. PROVISIONS GENERALLY APPLICABLE TO PUBLIC RETIREMENT SYSTEMS

CHAPTER 802. ADMINISTRATIVE REQUIREMENTS

Sec. 802.203. FIDUCIARY RESPONSIBILITY.

(a) In making and supervising investments of the reserve fund of a public retirement system, an investment manager or the governing body shall discharge its duties solely in the interest of the participants and beneficiaries:

(1) **for the exclusive purposes of:**

(A) **providing benefits to participants and their beneficiaries; and**

(B) **defraying reasonable expenses of administering the system;**

(2) **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;**

(3) by diversifying the investments of the system to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(4) in accordance with the documents and instruments governing the system to the extent that the documents and instruments are consistent with this subchapter.

(b) In choosing and contracting for professional investment management services and in continuing the use of an investment manager, the governing body must act prudently and in the interest of the participants and beneficiaries of the public retirement system.

(c) A trustee is not liable for the acts or omissions of an investment manager appointed under Section 802.204, nor is a trustee obligated to invest or otherwise manage any asset of the system subject to management by the investment manager.

(d) An investment manager appointed under Section 802.204 shall acknowledge in writing the manager's fiduciary responsibilities to the fund the manager is appointed to serve.

Texas Constitution Art. 16

Sec. 67. STATE AND LOCAL RETIREMENT SYSTEMS.

(a) General Provisions.

(1) The legislature may enact general laws establishing systems and programs of retirement and related disability and death benefits for public employees and officers. Financing of benefits must be based on sound actuarial principles. **The assets of a system are held in trust for the benefit of members and may not be diverted.**

...

(3) Each statewide benefit system must have a board of trustees to administer the system and to invest the funds of the system in such securities as the board may consider prudent investments. **In making investments, a board shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital.** The legislature by law may further restrict the investment discretion of a board.

SUBTITLE B. EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Sec. 815.307. DUTY OF CARE

The assets of the retirement system shall be invested and reinvested without distinction as to their source in accordance with Section 67, Article XVI, Texas Constitution. **A determination of whether the board of trustees has exercised prudence with respect to an investment decision must be made taking into consideration the investment of all assets of the trust or all assets of the collective investment vehicle, as applicable, over which the board has management and control, rather than considering the prudence of a single investment of the trust or the collective investment vehicle, as applicable.**

The assets of the retirement system shall be invested and reinvested without distinction as to their source in accordance with Section 67, Article XVI, Texas Constitution. Investment decisions are subject to the standard provided in the Texas Trust Code by Section 117.004(b), Property Code.

SUBTITLE C. TEACHER RETIREMENT SYSTEM OF TEXAS
SUBCHAPTER D. MANAGEMENT OF ASSETS

Sec. 825.301. INVESTMENT OF ASSETS. (a) The board of trustees shall invest and reinvest assets of the retirement system without distinction as to their source in accordance with Section 67, Article XVI, Texas Constitution....

Investment decisions are subject to the standard provided in the Texas Trust Code by Section 117.004(b), Property Code.

(a-2) The board of trustees may delegate investment authority and contract with one or more private professional investment managers for investment and management of not more than 30 percent of the total assets held in trust by the retirement system. In a contract made under this subsection, **the board of trustees shall specify any applicable policies, requirements, or restrictions, including criteria for determining the quality of investments or the use of standard rating services, that the board of trustees adopts for investments of the system.**

(b-1) By accepting a delegation of investment authority under Subsection (a-2) or an engagement to assist or advise the board or the staff of the retirement system under Subsection (b), a professional investment manager, advisor, or consultant submits to the jurisdiction of the courts of this state in all proceedings arising from or related to performance of the delegated authority or engagement.

c) The board of trustees shall employ one or more performance measurement services to evaluate and analyze the investment results of those assets of the retirement system for which reliable and appropriate measurement methodology and procedures exist. **Each service shall compare investment results with the written investment objectives developed by the board, and shall also compare the investment of the assets being evaluated and analyzed with the investment of other public funds.**

(e) **The board of trustees shall develop written investment objectives concerning the investment of the assets of the retirement system. The objectives may address desired rates of return, risks involved, investment time frames, and any other relevant considerations.**

Property Code Chapter 117. Uniform Prudent Investor Act
§ 117.004. Standard of Care; Portfolio Strategy; Risk and Return Objectives

(a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

- (1) general economic conditions;**
 - (2) the possible effect of inflation or deflation;**
 - (3) the expected tax consequences of investment decisions or strategies;**
 - (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;**
 - (5) the expected total return from income and the appreciation of capital;**
 - (6) other resources of the beneficiaries;**
 - (7) needs for liquidity, regularity of income, and preservation or appreciation of capital;**
- and**
- (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.**

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

**Uniform Management of Public Employee Retirement Systems Act [MPERS]
MPERS Requirements:**

A trustee with authority to invest and manage assets of a retirement system shall adopt a statement of investment objectives and policies for each retirement program or appropriate grouping of programs. The statement must include the desired rate of return on assets overall, the desired rates of return and acceptable levels of risk for each asset class, asset-allocation goals, guidelines for the delegation of authority, and information on the types of reports to be used to evaluate investment performance. At least annually, the trustee shall review the statement and change or reaffirm it. [MPERS §8(b)]

A trustee or other fiduciary shall discharge duties with respect to a retirement system:

- (1) Solely in the interests of plan participants and beneficiaries;**
- (2) For the exclusive purpose of providing benefits to participants and beneficiaries...; and**
- (3) With the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose.... [MPERS §7(103)]**

MPERS section 6 allows

- (a) A trustee or administrator may delegate functions that a prudent trustee or administrator, acting in a like capacity and familiar with those matters, could properly delegate under the circumstances.**
- (b) The trustee or administrator shall exercise reasonable care, skill, and caution in:**
 - (1) Selecting an agent;**
 - (2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the retirement program; and**
 - (3) Periodically reviewing the agent's performance and compliance with the terms of the delegation. [MPERS §6(a) and (b)(1 - 3)]**

Section 7(2) requires fiduciaries to be motivated only by the objective of providing benefits and paying reasonable expenses. [MPERS §8, Comments]

A public retirement system trustee's duty of loyalty requires that the interests of the party that appoints a trustee or fiduciary not be considered.

an employee benefit fund trustee is a fiduciary whose duty to the trust beneficiaries must overcome any loyalty to the interest of the party that appointed him.

National Labor Relations Board v. Amax Coal Co., 453 U.S. 322, 101 S. Ct. 2789, 69 L.Ed. 2 672

(1981).

MPERS §17(c)(12) and (13) require the plan to annually disclose:

- (12) **A description of any material interest, other than the interest in the retirement program itself, held by any public employer participating in the system or any employee organization representing employees covered by the system in any material transaction with the system within the last three years or proposed**
- (13) **A description of any material interest held by any trustee, administrator, or employee who is a fiduciary with respect to the investment and management of assets in the system, and, if the fiduciary is an individual, by a related person of the beneficiary, in any material transaction with the system within the last three years or proposed to be affected. [MPERS §17(c)(12) and (13)]**

In order to insure compliance with fiduciary duties, fiduciaries must not only live up to those duties, but document decisions to establish they complied with their duties and disclose that information.

Fiduciaries Must Insure That:²

! Investments are managed in accordance with applicable laws, trusts documents, and written investment policy statements (IPS) and are disclosed in a manner establishing compliance with those policies.

! Fiduciaries and parties in interest are not involved in self-dealing.

! The roles and responsibilities of all involved parties (fiduciaries and non-fiduciaries) are defined, documented, acknowledged and disclosed.

! Service agreements and contracts are in writing, do not contain provisions that conflict with fiduciary standards of care, are procured pursuant to a documented due diligence procedure and are appropriately disclosed.

! Fees for investment management are consistent with agreements and with all applicable laws and are appropriately disclosed.

! “Finder’s fees” or other forms of compensation that may have been paid for asset placement are appropriately applied, utilized, documented and disclosed.

! There is an IPS which contains the detail to define, implement, and manage a specific investment strategy.

! The investment strategy is implemented in compliance with the required level of prudence.

² This section taken from a pamphlet published by Fiduciary360 entitled *Defining a Global Fiduciary Standard of Excellence for Investment Advisors*.

Fiduciaries Must Identify:

- ! An investment time horizon.
- ! An acceptable risk level.
- ! An expected, modeled return to meet investment objectives.
- ! Asset classes that are consistent with the identified risk, return, and time horizon.
- ! Investment vehicles that are appropriate for the portfolio size.

Fiduciaries Must Establish Processes That:

- ! **Attribute and report costs, performance, and risk.**
- ! Monitor all aspects of the investment system to be consistent with assigned mandates.
- ! **Disclose any interests, gifts, compensation or other things of value of any kind that are received by any fiduciary from any investment advisor, investment manager or any other kind of service provider.**
- ! Compare investment performance against appropriate index, peer group, and IPS objectives.
- ! Periodically review the organization's effectiveness in meeting its fiduciary responsibilities.
- ! Periodically review fees paid to service providers to insure they are reasonable.

Questions Fiduciaries Should Ask:

1. Are investments managed in accordance with a written Investment Policy Statement (IPS)?
2. Have all parties demonstrated an awareness of their duties and responsibilities?
3. **Have all parties acknowledged their fiduciary status in writing?**
4. **Are policies and procedures defined?**
5. **Do all employees annually acknowledge applicable ethics policies and agree to disclose any potential conflicts of interest?**
6. Has the appropriate asset/liability study been factored into the time horizon?
7. Has the “worse-case” scenario been considered?
8. Is the “expected” or “modeled” return consistent with investment goals and objectives?
9. Are the “expected” or “modeled” return assumptions for each asset class based on reasonable risk-premium assumptions?
10. **Is there a documented due diligence procedure for selecting investment options and is that procedure disclosed?**
11. **Is there a documented due diligence process applied to select service providers and is that procedure disclosed?**
12. Is the performance of each investment option periodically compared against the appropriate index, peer group, and due diligence procedure defined in the IPS?
13. **Has a summary of all parties being compensated from trust assets been disclosed?**
14. **Are the fees paid to each party reasonable, periodically examined and disclosed?**
15. Are the fees paid for various services periodically compared to industry benchmarks?
16. **Have all parties compensated from trust assets, along with the amount (or schedule) of**

their compensation, been identified, documented and disclosed?

17. Has compensation paid from portfolio assets been determined to be fair and reasonable for the services rendered?
18. **Are reviews conducted at planned intervals to determine whether appropriate policies and procedures are in place to address all fiduciary obligations that are documented and disclosed?**
19. Are assessments conducted in a manner that ensures objectivity and impartiality?
20. **Are there compliance policies and procedures manuals that are disclosed?**
21. Is there compliance training?
22. **Are compliance breaches documented and reported to the board and appropriate regulators?**
23. **Are there documented defined policies and procedures and designated senior staff for overseeing and managing conflicts of interest?**
24. Is there a dedicated investment risk management oversight committee that regularly reviews the activities and investment risk of investment managers?
25. Are risk-management tools used to assess overall portfolio risk and the risk within major asset classes?

26. Is there a formal portfolio review process to ensure adherence to investment policies and mandates?
27. **Is the portfolio management process for each distinct investment strategy clearly defined, focused, and documented?**
28. Is the asset allocation consistent with the stated long-term goals of strategy?
29. **Is portfolio performance accurately calculated, verified and disclosed?**
30. Are investment goals set solely in relation to achieving returns to pay for existing benefits without seeking to gain excess returns in hopes of expanding benefits?