

BLB&G Bernstein Litowitz
Berger & Grossmann LLP

New York • California • Louisiana • Illinois



FIDUCIARY DUTY 101

The Pennsylvania Association of Public
Employee Retirement Systems
9th Annual Spring Forum
Harrisburg, Pennsylvania
May 2013

Hannah Ross
Jeremy Friedman
1285 Avenue of the Americas
New York, NY 10019
(212) 554-1400
hannah@blbglaw.com
jeremyf@blbglaw.com

Foundations of Fiduciary Law

- ▶ No fiduciary relationship is more complete and nearly as absolute as the relationship between a public pension fund trustee and a pension beneficiary.

“A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior ... the level of conduct for fiduciaries [has] been kept at a level higher than that trodden by the crowd.”

Justice Benjamin Cardozo, *Meinhard v. Salmon*

General Fiduciary Guidelines

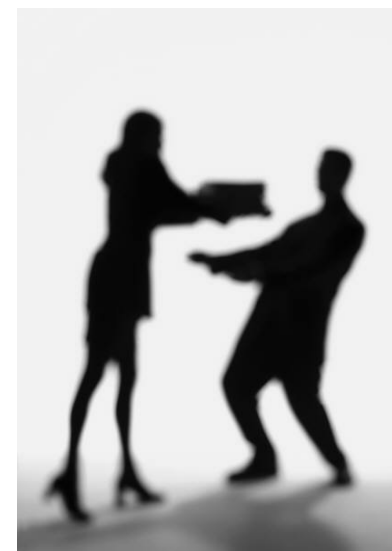
- ▶ A trustee seeking to properly fulfill his or his governance duties is charged to act in all matters associated with the fund with:
 - Loyalty
 - Prudence
 - Skill
 - Care
 - Diligence

The Limits of the Trustee's Role

- ▶ Trustees are not expected to personally investigate all agents and consultants who handle fund assets.
- ▶ Trustees establish the standards and protocols that the fund, its staff and consultants must employ when conducting due diligence of asset managers and investment advisors.
- ▶ Trustees may delegate the actual selection of asset managers and investment advisors to consultants and staff but that delegation must be made pursuant to the established standards and protocols for assessing those who will handle the fund's assets.

Duty to Delegate

- ▶ Public pension fund trustees can not be held to learn and understand all matters under their supervision.
- ▶ Thus, the trustee has the duty to delegate those tasks the trustee cannot properly do himself or herself. But, delegating in and of itself will not relieve a trustee from liability.



Duty to Delegate (cont.)

- ▶ Whether to delegate is a question of prudence.
- ▶ When delegating the following applies:
 - The duty of care in selecting qualified personnel.
 - The duty to specify the scope of the delegation.
 - The duty to monitor the agent and ensure the delegated duty is carried out in the best interest of beneficiaries.
 - The duty of loyalty to select an agent on the basis of the interests of beneficiaries.
- ▶ KNOW YOUR ADVISOR – Delegation to an external manager is appropriate only once the staff or consultant have satisfied themselves as to the manager's experience, expertise and investment thesis.

Liability for Breaching Fiduciary Duties

- ▶ A trustee can be liable for a loss resulting from his or her failure to use the care and skill required of a trustee.
- ▶ Adherence to fundamental fiduciary duties is the best way to protect your fund and yourself.
 - Care
 - Diligence
 - Loyalty

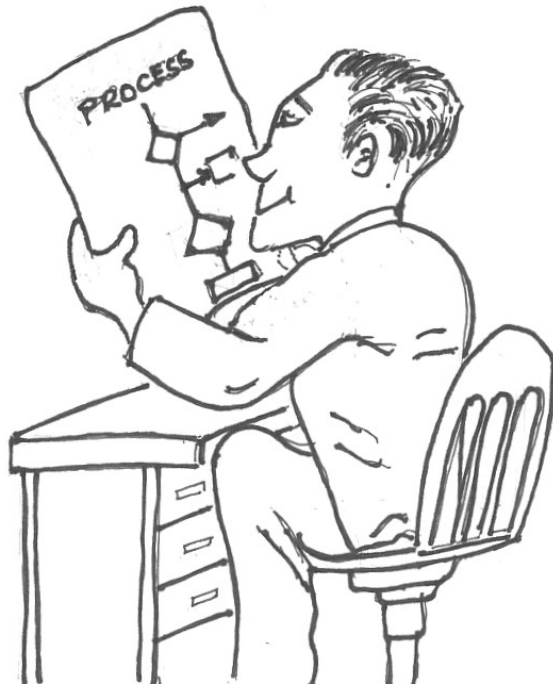


Duty of Care

- ▶ A trustee must apply watchful attention to his or her duties.

- ▶ In practical terms this means the trustee must:
 - Ensure collection of funds and monies due to the plan.
 - This may include bringing suit to recover monies owed the fund.
 - Ensure beneficiaries receive all benefits owed.
 - Ensure beneficiaries are informed on a periodic basis of the operations and financial health of the plan.
 - Maintain the fund with up-to-date investments.
 - Minimize the risk of loss by ensuring reasonable diversification.

Diligence



- ▶ Diligence means the attention and care legally expected or required of a person.
- ▶ For a public pension plan trustee, it means he or she must diligently pay attention to the details of his or her work.

Diligence

- ▶ All trustees should, in pursuit of diligence:
 - Ask the investment officer to explain the current fund asset allocation to you.
 - Ask to have the various performance benchmarks explained to you.
 - Network with other trustees.
 - Learn to understand actuarial reports. These reports spell out the financial health of your system.
 - Obtain advice from experts (whether legal counsel, investment advisors or others) to answer questions you may have.

Diligence

- ▶ All trustees should, in pursuit of diligence (cont.):
 - Prepare for and attend all Board and committee meetings.
 - Read the statutes and internal policy/mission statements concerning your plan, including ethics policy statements.
 - Be familiar with the annual financial reports of your plan, as well as the auditor's reports.
 - Establish a working knowledge of the state's open records and open meetings laws as well as state ethics laws.
 - Become familiar with the qualifications and reputation of the plan's auditor, investment consultant and actuary.

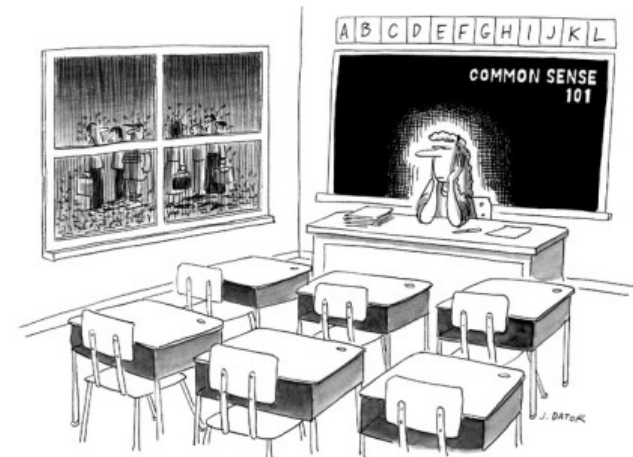
Duty of Loyalty

- ▶ Trustees should avoid conflicts of interest or even the appearance of conflicts of interest.
- ▶ Ensure that any connections between trustees and potential external advisors are fully disclosed.
- ▶ Ensure that trustees with conflicts are recused from relevant Board discussions.



Common Sense

- ▶ Use your common sense in approaching decisions. If a deal looks too good to be true – often it is.
- ▶ Don't allow yourself to be pressured into making a decision.
- ▶ Don't ever be afraid to ask questions.
- ▶ “Front page test” should be one of your everyday benchmarks.



Common Sense



- ▶ Don't lose sight of the fact that the ultimate responsibility for the fund lies with the Board. Thus, the buck stops with you.
- ▶ If you believe a staff member or external advisor is not properly serving the fund, you have an affirmative obligation to address the problem.
- ▶ If your gut feeling is that there is some problem, follow through on your feeling. Trustees are just as liable for doing nothing as they are for doing the wrong thing.

Corporate Directors Also Owe Fiduciary Duties

- ▶ Just like trustees, directors of the companies in which the fund invests also stand in a fiduciary relationship.
- ▶ Directors' fiduciary duties are owed to the company's shareholders, including the fund.
- ▶ Directors' must discharge their duties with:
 - Care
 - Loyalty
 - Good faith



Trustees Can Play Critical Role in Ensuring Corporate Directors Comply with Their Fiduciary Duties



- ▶ Best practices include retaining at least one law firm to serve as portfolio monitoring counsel for the fund.
- ▶ Monitoring counsel will keep the fund apprised of potential breaches of fiduciary duty and other corporate misconduct affecting the fund's investments.
- ▶ Upon the recommendation of monitoring counsel, the fund can (but is not obligated to) initiate litigation to seek redress.

RECENT EXAMPLES OF PUBLIC PENSION FUNDS POLICING BREACHES OF FIDUCIARY DUTY



News Corp. Derivative Litigation

The logo for News Corporation, featuring a globe icon followed by the text "News Corporation" in a white serif font, all set against a dark blue rectangular background.

▶ Facts

- The News Corp Board is dominated by Chairman, CEO and controlling shareholder Rupert Murdoch.
- Board “rubber-stamps” purchase of Rupert’s daughter’s media company for an inflated price and agrees to add her to the Board.
- Highly-publicized scandal erupts revealing that Company’s news reporters and investigators were hacking into cell phones and computers of thousands of people and bribing public officials for confidential information.
- Despite rampant criminality throughout News Corp’s operations, the Board does nothing.

▶ Settlement

- News Corp agrees to pay \$139 million and sweeping implement corporate governance changes to help prevent this type of misconduct from recurring at the Company.

El Paso Corporation



▶ Facts

- \$40 billion sale of El Paso to competitor Kinder Morgan.
- Goldman Sachs on both sides of deal.
 - \$4 billion equity stake in Kinder Morgan and two Kinder Morgan Board seats
 - Financial advisor to the El Paso Board
- El Paso senior management laboring under undisclosed conflicts.
- Shareholders deprived of highest price reasonably available.
- Public pension fund initiates lawsuit challenging El Paso Board's breaches of fiduciary duty and Goldman Sachs' involvement in aiding and abetting the Board's breaches.

▶ Settlement

- Challenge by public pension fund yields \$110 million settlement.

Delphi Financial Group Inc.



▶ Facts

- Robert Rosenkranz was Delphi's founder, Chairman, CEO and controlling shareholder.
- Delphi's charter prohibited payment of differential consideration to Rosenkranz in any buyout.
- In connection with the sale of Delphi to competitor Tokio Marine, Rosenkranz nonetheless expropriated an additional \$55 million that should have been shared with the Company's public shareholders.
- Public pension fund initiates lawsuit challenging Rosenkranz's "money grab."

▶ Settlement

- Case resulted in a \$49 million settlement
 - 90% of potential class damages

Questions

