FLORIDA DIVISION OF RETIREMENT 45th ANNUAL POLICE OFFICERS' AND FIREFIGHTERS' PENSION TRUSTEES' CONFERENCE

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Litigation, Taxes, and Divestment - The Uncertainty Continues

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COURTROOM CONFUSION CONTINUES

New Jersey Supreme Court Strikes Down Funding Reform

On June 9, 2015, the New Jersey Supreme Court, by a 5-2 vote, refused to enforce the funding provisions of a 2011 law (Chapter 78) hailed as a solution to New Jersey's long-standing pension funding crisis. The majority decision by Justice LaVecchia held that notwithstanding Chapter 78's "historic compromise" and the Legislature and Governor's clear intent to create an enforceable contractual right to pension funding, "Chapter 78 cannot constitutionally create a legally binding, enforceable obligation on the State to annually appropriate funds as Chapter 78 purports to require."

The Court agreed with plaintiffs, a group of labor unions, that a "promise was made by the legislative and executive branches when enacting Chapter 78". The Court

concedes that morally plaintiffs' argument is "unassailable". Yet, the Debt Limitation and Appropriations-related clauses in the New Jersey Constitution interdict the creation "of a legally binding enforceable contract compelling multi-year financial payments in the sizable amounts called for by Chapter 78."

Interestingly, the majority decision does not strike down or invalidate Chapter 78. Rather, the Court explains that, "we are not declaring Chapter 78 unconstitutional … Chapter 78 remains in effect, as interpreted, unless the Legislature chooses to modify it." Significantly, they did not hold that the promise to pay the obligation within seven years according to a prescribed formula was in and of itself unconstitutional. Only the promise to actually fund that obligation through an appropriation each year was held unconstitutional.

As repeatedly emphasized by the Court, appropriations should be determined annually by the elected branches of government who are accountable to the voters.

According to the Court:

> The responsibility for the budget process remains squarely where the Framers placed it: on the Legislature and Executive, accountable to the voters through the electoral process. Ultimately, it is the people's responsibility to hold the elective branches of government responsible for their judgment and for their exercise of constitutional powers. This is not an occasion for us to act on the other branches' behalf.

The majority decision did affirm that the underlying right by members and beneficiaries to payment of retirement benefits remains intact:

> We reiterate that there is no question that individual members of the public pension systems are entitled to this delayed part of their compensation upon retirement, but, as stated at the outset, that is not in question in the instant matter before this Court. That said, the State repeatedly asserted at oral argument that it is not walking away from its obligations to the pension systems and to pay benefits due to retirees.

Additionally, the Court acknowledged that the Legislature and Governor's well-intentioned efforts intended to create a contractual arrangement addressing pension funding "to promote the fiscal health" of the retirement systems. Likewise, the Court understood "the importance of maintaining the soundness of the pension funds" and bemoaned that "the loss of public trust due to the broken promises made through Chapter 78's enactment is staggering." But after narrowly focusing strictly on the legal question presented, the Court determined that the contractual pension

appropriation provisions in Chapter 78 were not enforceable. In so holding the Court agreed that the case presented a "matter of great public importance to members of the public pension systems and citizens throughout the State."

The vigorous dissent by Justice Albin and Chief Justice Rabner observes, among other things, that the majority decision unfairly requires public workers to uphold their end of the bargain while allowing the State to shirk "its binding commitment" to fund the retirement systems. The dissent worried that public workers continue to pay into a system "on its way to insolvency." The dissent also chastised the majority's "cheery assurance" that there was "no question" but that each person's pension would have to be paid in full, since under the majority's ruling "the political branches . . . can let the pension fund run dry and leave public service workers pauperized in their retirement."

As a result of this decision, the New Jersey funding crisis remains unsolved and the state systems continue to edge toward insolvency. This problem was made even worse when, on June 30, the Governor vetoed the 2016 appropriation designed to reignite the Chapter 78 payment plan. The Retirement Systems have brought a separate suit to reduce the unfunded liability to a judgment which can be enforced under existing state law. The trial court dismissed that case in October 2015. An appeal is pending.

Burgos v. New Jersey, 118 A.3d 270 (N.J. 2015)

Individual Members Of A Board Of Trustees Could Assert A Claim Against Fellow Board Members For Breach Of Duty

Trustees of the New Orleans Firefighters' Pension and Relief Fund filed a petition for mandamus to compel the City of New Orleans to make certain statutory contributions owed to the Fund. The City responded with a counter-claim against the Trustees, alleging they mismanaged the investments and assets of the Fund. The circuit dismissed the counter-claim as stating no cause of action and appellate court affirmed. Norman Foster, in his official capacity as Chief Financial Officer and Director of Finance of the City of New Orleans, wanted to amend the counter-claim to assert a cause of action as a statutorily named member of the Board of Trustees. In that capacity, Foster asserted he had a statutory duty to remedy any breach by another trustee of which he had knowledge and should be allowed to amend his petition to state his cause of action. The Louisiana Supreme Court held that because the city's counter-claim alleged various trustees breached their fiduciary duties to the Fund through their mismanagement, Foster, as a member of the Board and in accordance with his statutory duty of accountability, should be allowed to

amend the petition independently to clearly state his cause of action in his capacity as a board member. Following this decision, in an earlier related action, the Mayor and City were held in contempt of court for failing to make $75 million in back contributions which the Supreme Court had ordered a year before. On the eve of the final contempt hearing which could have resulted in house arrest for the Mayor, the parties settled their differences, resulting in a binding payment program and the dismissal of all claims against the current and former trustees.

New Orleans Fire Fighters Pension & Relief Fund v. City of New Orleans, 157 So.3d 581 (La. 2015)

Spouse Loses Pension Benefits as Well as the Convicted Member

A former employee of the Pennsylvania Department of Transportation took a refund of contributions in 1979 after 6 years of service. Twenty years later, the employee rejoined the system after being elected as a judge. He purchased his prior service and also bought military time. In 2011 he was charged with bribery and indecent assault after demanding sexual favors from two women in landlord tenant cases before him in return for favorable rulings. In 2012, the judge pled guilty to crimes which constituted forfeitable offenses under Pennsylvania law. Shortly thereafter, the System informed the judge and his spouse of nearly 50 years that he would lose all of his benefits, not just the years served as a judge. On appeal, the Pennsylvania Commonwealth Court held that the conviction required a forfeiture of all years of service, and not just those as a judge. Similarly, the court rejected the spouse's claim that as an innocent person she was entitled to a marital share.

Cioppa v. SERS, 2015 WL 5457851 (Pa. Cwlth 8/2/2015).

Georgia Supreme Court Upholds Contribution Increase

Members of the Atlanta defined benefit retirement plans filed suit against the city for breach of contract and impairment of contract after the city enacted ordinances increasing employee contributions on a prospective basis. The Georgia Supreme Court held that whether an employee is vested or not, benefits earned during periods of service are vested against retroactive diminution. The court continued however, that employee contributions are a condition of enrollment and do not constitute a vested benefit. The court reached this conclusion on the basis that the enrollment provisions contemplated amendment. This follows the concept that vested rights include a reserved power of government to alter the pension program on a prospective basis.

Borders v. City of Atlanta, ___S.E.2d___, 2015 WL 6630457 (Ga. 11/2/2015)

Louisiana Supreme Court Permits Correction of Errors

In 2009, the president of Southern University retired after 35 years of service at a pension of $300,000 per year. That same year the president filed suit against the university for past due wages. Following a trial, the court found the president had manipulated his salary calculation and should only have retired based on a salary of $220,000. After that decision, the state retirement system (LASERS) informed the president that his pension had been miscalculated and he should be receiving a lower pension. LASERS advised that the benefit would be adjusted retroactive to the date of retirement. The president filed suit claiming this violated his statutory and constitutional rights despite a statute mandating correction of improper pension payments. Following an unsuccessful result in the trial and middle level appellate courts, the state Supreme Court sided with the retirement system and upheld the recovery process.

Slaughter v. LASERS, **____So.3d____, 2015 WL 59772526 (La. 10/14/2015).**

Overpayment Must Be Subject to Equitable Consideration

A 75 year old former college employee was re-enrolled post retirement in a PERS eligible position. As a result, he was overpaid by nearly $90,000. PERS moved to recoup the over-payments. An administrative law judge found that the retiree had not acted with malice and had no reasonable basis to know that he was in a position that was not statutorily authorized. On review, the appeals court found that even though the retiree was out of compliance with the statute, equitable considerations required an interpretation that balanced the needs of the System with those of the employee. As a result, the case was returned to PERS to reconsider the reimbursement and to fashion “an equitable remedy.”

Zagorski v. PERS, ____A.3d____, 2015 WL 6113238 (N.J. Super. 10/19/2015).

Kentucky Retirement Systems Prohibited from Recoupment on Equitable Grounds

A retired employee of the state cabinet began working for a state contract agency that was retirement eligible. A year later, the retiree was informed that her employment violated the state retirement law and that she must repay all retirement benefits received as well as health insurance premiums. A state hearing officer rejected her claims but a state trial court reversed finding that the state was equitably prevented from recovering the money. On review, a state appeals court affirmed, finding a failure on the part of both the retirement system and the employer to properly advise the employee. Therefore, equitable principles prohibit the ability of the system to recoup prior payments.

Kentucky Retirement Systems v. Stephens, ____S.W.3d____, 2015 WL 5895314 (Ky. App. 10/9/2015).

Retirement System Has No Duty to Meet Agency Conditions for Recovered Disability Retiree

A special agent with the California Department of Justice was disabled due to several on-the-job injuries. In 2009, she applied for reinstatement on the basis of recovery. A medical review by the retirement system in 2010 found she had recovered. The agency agreed to reinstate the retiree provided she underwent medical and psychological evaluations and a background investigation. The retiree refused. The agency appealed CalPERS order of reinstatement and the state personnel board found the agency had constructively discharged the employee. On review, a state appeals court sided with the employee and CalPERS. The court found that the pension system's interpretation of the law was entitled to deference and even if it was not, the retirement law should be liberally construed in favor of the participant. The state law unambiguously mandated reinstatement for a disabled peace officer who was deemed recovered from the disabling injury. The agency's attempt to impose additional conditions was beyond its authority and constituted a rewriting of the law. As a result, the court ordered the employee reinstated with back pay. Once back on the payroll, it was free to review her fitness for duty on the same basis and under the same conditions as it could any other employee.

California Dept. of Justice v. Board of Administration, 2015 WL 5937021 (Cal. App. 10/13/2015)(unpublished).

Absence of Beneficiary Designation Mandates Payment to Estate

A Massachusetts state trooper died in 2007. Following his death, his daughter filed a claim for death benefits. No beneficiary form was on file with the plan, and the plan

paid the death benefits in a lump sum to the trooper's estate. A state administrative judge found that the absence of a form did not mean that one had not been filed and ordered payment to the daughter based on her affidavit and one from the late trooper's girlfriend that the trooper had filed a beneficiary form. The state retirement review board reversed finding an absence of credible evidence that a beneficiary form had been filed. A state trial court affirmed that decision. On appeal, the court found that the pension review board decision was entitled to deference. Neither "witness" had any personal knowledge concerning the filing of the beneficiary form, nor was there any evidence that any of the customary steps to designate a beneficiary had occurred. As the daughter bore the burden of proof, the court reasoned she had failed to carry that burden and the order paying the benefits to the trooper's estate was affirmed.

O'Grady v. Contributory Retirement Appeals Board, 36 N.E.3d 78, 2105 WL 5009266 (Mass. App. 8/25/2015).

Civil Service Commission Lacks Legislative Authority

A coalition of labor unions representing employees covered by the state civil service act challenged a law increasing employee contributions to the state retirement plan and reducing the value of future accruals. The suit claimed that since the state civil service commission had the authority to set employee compensation, the reduction of benefits invaded that constitutional authority. A state appeals court agreed with the unions and declared the law unconstitutional. On review, the state supreme court reversed. The court found that pension legislation was not within the definition of "rates of compensation" and that the legislature had the exclusive authority to regulate retirement benefits. The supreme court looked to the state constitutional provision making pension benefits a contract between the state and the employees. As such, pension was an individual right separate and apart from class wide rates of compensation. The supreme court reversed the lower court decision and upheld the pension legislation.

Coalition of State Employee Unions v State. ___N.W.2d___, 498 Mich. 312 (7/29/2015)

Failure to Give Proper Notice to Widow Allows Belated Challenge

Following the death of the member, the New York State and Local Retirement System paid death benefits to the member's son and former spouse in accordance with the beneficiary designation. Two years later, in response to a letter, the Fund

informed the employee's widow that it had already paid death benefits. The widow sued claiming she should have been notified of the member's death and the benefit distribution. The claim was dismissed as untimely. On review, the appeals court found that the absence of notice to the widow prevented the time limit to file a claim from running. Additionally, the court held that the beneficiaries who did receive payment had to be joined in the suit because their property rights could be affected.

Colavito v. New York State Comptroller, 13 N.Y.S.3d 674 (N.Y. App. 7/9/2015)

Divorce Order Cannot Require Specific Benefit Election

The ex-wife of a deceased PERS member filed an action against the system and the member's widow for retirement benefits. The widow also sued PERS claiming she should have been awarded a different level of benefits. The System wanted the widow to repay any previously awarded benefits if the level of survivor pension changed.

At the time of the member's death, a disability retirement application was pending. Upon the member's death the widow was paid a disability benefit rather than a larger pre-retirement death benefit. Under the terms of the member's divorce decree and the supporting QDRO, the ex-wife was promised a measure of benefits. The Board rejected the first QDRO as not conforming to the plan statute. A year after the divorce, the member remarried. Ten days after the wedding, the member filed for disability retirement. While that application was pending, the member died three month later. At the time of the member's death, no valid QDRO had been approved, so the ex-wife's claims were rejected. A posthumous QDRO was also rejected as the plan had no authority to accept a QDRO after the death of the member. At the same time, the Board awarded a retroactive disability benefit to the widow.

Ultimately, the state supreme court had to untangle the mess. Firstly, the court found that the plain language of the statute mandated the payment of the higher death benefit. The member's death while the disability process was still pending effectively cancelled that application and required the higher death benefit be paid to the widow. Further, the Court held no repayment was required and the death benefit would be prospective only. Secondly, absent a valid QDRO, the system could not pay the ex-wife, despite the language in the divorce decree. Under the governing pension law, a QDRO was required to give effect to the decree. Lastly, the court sent the case back to Family Court for preparation of a posthumous QDRO.

Jones v. West Virginia PERS, 775 S.E.2d 483 (6/10/2015)

Retiree Entitled to Retain Health Insurance

A retired city employee claimed benefits under the City of Slidell insurance plan upon attaining age 65. At the time the employee retired, at age 60, retirees who attained age 65 were entitled to City paid health insurance. After the employee retired, but prior to his 65th birthday, the City amended the ordinance, requiring retirees to purchase Medicare coverage which provided less coverage than the City plan. The employee sued claiming a vested right to retiree healthcare. The City moved to dismiss claiming the statute of limitations ran 3 years after the ordinance was adopted rather than when the employee was denied coverage. A trial court denied the motion to dismiss and entered judgment for the employee. An appeals court affirmed the ruling. On review in the state supreme court, the employee's right to insurance was upheld. He became vested in the benefit when he retired and the City's attempt to divest him of those rights post retirement was an illegal breach of contract. The Court expressly found the insurance to be a vested retirement benefit which could not be retroactively diminished.
Born v. City of Slidell, ____So.3d____(La. 10/14/2015)

REHIRING RETIREES - WHAT ARE THE RISKS?

In a case decided in late September, the Missouri Appeals Court upheld a trial court decision finding that a school superintendent who retired on December 31st and returned as a "consultant" on January 1st had not actually retired as required by statute to be able to receive a retirement benefit. The school superintendent was a participant in the Public School Retirement System of Missouri, which requires actual retirement from service in order to begin drawing a pension benefit. The statute further permits a limited number of hours of post-retirement work at no more than half of the pay for the particular position held. The superintendent retired on December 31, 2005 but on January 1, 2006 continued in the same position but violated the 550 hour re-employment limit. As a result, the Retirement System held that for the 18 months following the beginning of the contract extension, the superintendent was required to reimburse the Retirement System for his improperly received benefits. *Public School Retirement System of Missouri v. Taveau*, ___S.W.3d ___, 2015 WL 5571946 (Mo. App. 9/22/2015).

This retire-rehire practice which gave rise to the *Taveau* case is by no means unique. Employers throughout the country are dealing with the tax consequences of rehiring retirees who did not satisfy the Internal Revenue Service rules for in-service distributions (retirees receiving a pension and re-employed by the same employer)

due largely to the failure to meet the normal retirement age (NRA) regulations (age 50 for public safety and age 62 for all other public employees).

The primary issue for governmental plans has been the growing trend of employers to immediately rehire retirees. The purpose is to keep the services of a seasoned employee who will be allowed to draw a salary and a pension. This has the effect of eliminating the need to add an additional employee to the pension rolls and also serves to preserve the Social Security exemption for those employers who have maintained the Social Security opt out.

Many governmental plans, however, do not have provisions for in-service distributions. Following the plan document is an essential element of maintaining plan qualification. The IRS has also looked at the prearranged retire/rehire arrangements as not being bona fide separations.

In considering in-service distribution issues, it is advisable to remember the most recent IRS guidance on retire/rehire agreements. In PLR 201147038, issued in late 2011, the IRS found that persons retiring in order to qualify for a benefit while, at the same time, the employer and employee had an explicit understanding regarding continuing on the same job, the employee was not deemed "retired."

Many employers seek to avoid this issue through independent contractor arrangements in lieu of common law employment relationships. In a February 28, 2013 decision, *Kurek v. Commissioner of Internal Revenue*, T.C. Memo 2013-64 (U.S. Tax Ct. 2013), the U.S. Tax Court reviewed the distinctions between an "employee" and an "independent contractor."

In order to qualify as an independent contractor, a 7-part common law test has been applied by the Tax Court. The factors to be considered are:

1. The degree of control exercised by the principal over the work performed.
2. Which party invests in the facilities used by the worker.
3. The opportunity of the worker for profit or loss.
4. Whether the principal can discharge the worker.
5. Whether the work is part of the principal's regular business.
6. The permanency of the relationship.
7. The relationship the parties believed they were creating.

The greater the amount of control exercised by the principal and the more regular the hours, the more likely the IRS is to find that the individual is an employee rather than a contractor. While the belief of the parties concerning the nature of the relationship they were creating weighs in favor of a contact relationship, it is by no means the

controlling factor. In the end, this is a fact-intensive analysis. An additional factor likely to arise is how common such relationships are in the work place among recently retired employees.

Again, guidance is uncertain. Employers wishing to rehire retired employees AND permit them to receive in-service distributions are best advised to amend the plan to clearly permit in-service distributions and limit such events to public safety personnel over the age of 50 and non-public safety to not less than age 62.

RESPONSIBLE INVESTING - DOING WELL BY DOING GOOD

A. Environmental, Social and Governance (ESG) - Incorporates these issues into the investment decision making process as a means to enhance returns and reduce risk. Additionally, these approaches may involve active proxy voting, company engagement, and public policy work.

B. Mission Related Investing is a more focused type of ESG and is closely aligned with the mission of the organization. For example, one large church pension plan will not invest in stocks relating to gambling, firearms, alcohol, or private prisons. Church plans have even greater flexibility as they are unregulated by either state law or ERISA. The decision to invest or refrain from investing in certain industries is deemed a matter of faith and is exempt from judicial or legislative interference under the First Amendment of the U.S. Constitution and comparable state constitutional provisions respecting freedom of religion.

C. Sustainable investing is generally focused on investments in companies addressing issues relating to conservation of natural resources, such as energy, air, and water.

D. Currently billions of dollars of public and private pension money have been placed into economically targeted investments (ETI's) which are designed to create jobs, boost local economies or create affordable housing.

E. The Labor Department began issuing responsible investing guidance for ERISA plans as early as 1998. Fund trustees were reminded that loyalty to the plan, diversification, and prudence were the primary investment determinants. Responsible investing was criticized for failure to provide a solid economic

return to the pension fund. Later research has not shown a compelling economic difference. Focus has shifted from negative screening (limiting the opportunity set) to positive screening, yielding a more balanced approach of integrating the ESG principles into the overall investment decision making process.

F. Social investing has been approved in the context of a political decision rather than a highest and best rate of return investment. *See, Board of Trustees v. City of Baltimore,* 562 A.2d 720 (Md. 1989). The Maryland high court held that requiring South African divestment did not impair the pension contract or subvert the purposes of the System when the plan sponsor adopting the requirement was willing to bear any economic consequences of the political decision.

G. Directed Investment In Prisons Held Not To Impair Constitutional Rights of Members.

The West Virginia Legislature passed a bill directing the state pension board to invest $150 million of the state retirement fund assets in the jail authority for ongoing construction and renovation projects. The investment was for five years and had a guaranteed investment return equal to the fixed income portfolio of the system, but not less than 5%.

The pension board refused to transfer the $150 million based on its belief that it impaired the rights of members to their constitutionally-guaranteed pension benefit. The appeals court disagreed holding that as long as the state continued to pay the benefits of members that the contractual right to a pension was not impaired. The court held that the contract right was not as to the assets, but rather as to the "promised pay." The court held it was also not unconstitutional to direct the pension board's power to invest.

State Regional Jail and Correctional Facility Authority v. West Virginia Investment Management Board, 508 S.E.2d 130 (W.Va. 1998)

H. Darfur Investment Restrictions Struck Down by Federal Court.

In an effort to deny support for the government of Sudan and its affiliated Jinjaweid militia in light of the atrocities and genocide in Darfur, the state adopted the Illinois Act to End Atrocities and Terrorism in the Sudan. The act attempted to impose various restrictions on the investment of public pension funds in Sudan-connected entities and on the deposit of state funds in financial institutions whose customers have certain links with Sudan. Among other things, the Act amended the Illinois Pension Code to prohibit the fiduciary of any pension fund established under the Code from investing in any entity

unless the company managing the fund's assets certified that the fund managing company has not loaned to, invested in, or otherwise transferred any of the retirement system or pension fund's assets to a forbidden entity any time after the effective date of the Act. Several Illinois municipal pension funds and beneficiaries challenged the constitutionality of the statute in a suit brought under 42 USC 1983 against the state treasurer and attorney general. The plaintiffs argued that the Act is preempted by federal law governing relations with Sudan, interferes with the federal government's ability to conduct foreign affairs, violates the Constitution's Foreign Commerce Clause, and is preempted by the National Bank Act. The court recognized that the Illinois legislature acted with laudable motives. The Federal District Court for the Northern District of Illinois held that the Illinois act violated various federal constitutional provisions precluding the states from "taking actions that interfere with the federal government's authority over foreign affairs and commerce with foreign countries." The District Court enjoined the state from enforcing the act.

National Foreign Trade Council v. Alexi Giannoulias, 2007 WL 627630 (N.D. Ill. Feb. 23, 2007).

Congress later acted to enable state action in the Sudan Accountability and Divestment Act of 2007.

I. Constructive Engagement.

Many states, as an alternative to divestiture, have adopted laws requiring constructive engagement. This involves requiring managers to inquire of companies holding stock in areas of concern to directly engage those companies to seek change within the challenged area. Florida has a direct prohibition relating to Cuba in 215.472, which will be directly impacted by recent federal outreach to normalizing relations with Cuba. For example, as an alternative to divestment, which would have substituted the legislature as the fiduciary for the boards of trustees, Louisiana law encourages public retirement systems to engage companies to foster change from within rather than simply withdraw from the marketplace. This shifted the decision making back to the boards of trustees who are tasked with ensuring positive investment performance, based on non-political factors.

J. Divestiture of Fossil Fuels.

1. Generally shunned by pension plans and large endowments as destructive of the mission of achieving the highest and best return at a reasonable risk.

2. Divestiture has most recently been criticized for loss of an investor voice in a critical industry that directly impacts virtually every economic sector in which pension plans are invested.

3. The goals of ESG, particularly in the area of sustainability, are directly compromised by loss of the presence at the corporate table, thereby making divestment of fossil fuels a “futile act,” according to Professor Edward Zelinsky of the Cardozo School of Law.

4. California adopted SB 185 in October 2015 requiring CalPERS and CalSTRS to divest themselves of thermal coal (coal for the production of electricity unless to do so would be a breach of the trustees’ fiduciary duty.

5. The first question to be asked in any mission-based divestment decision is whether the divestment will advance or damage the long term return of the System or will otherwise enhance or resist risk management in the portfolio. If the increased risk or diminished return is the most likely result, the social issue, no matter how worthy must take a “back seat” to the primary mission of the fiduciary to invest System assets for the highest and best return with a reasonable degree of risk.

K. <u>Department of Labor Issues Advisory Opinion on Political Proxies</u>.

1. The U.S. Department of Labor, which regulates ERISA plans, issued a recent advisory opinion which may have influence on governmental plan efforts to address political issues in proxy matters. Fiduciaries are required to act in the best interest of the members of the retirement plan. This includes the duty to exercise proxy votes on issues that affect the value of plan investments. The DOL stated it is the duty of fiduciaries to weigh the cost of developing proxy resolutions, proxy voting services and the likely effect of such activities on the value of the plan investment.

2. The DOL went on to state that any activities designed to monitor or influence the management of a corporation is consistent with the fiduciary duty under ERISA only to the extent it is expected to enhance the value of the plan investment in an amount over and above the cost of the activity. The opinion clearly advises fiduciaries against proxy activities that relate to political or social issues unless it can be shown that the activity will also enhance the value of the stock. DOL Advisory Opinion 2007-07A

L. What is the ERISA Standard?

2509.94-1 Interpretive Bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor's interpretation of Sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in "economically targeted investments" (ETI's), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. Sections 403 and 404, in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a-1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of Section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available

alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate section 404(a)(1) (A) and (B) and the exclusive purpose requirements of section 403. [59 FR 32607, June 23, 1994]

M. The Department of Labor Revisits ETIs in October 2015

On October 26, 2015, the Labor Department published additional guidance on ETIs for the first time since 2008. Based on continued confusion about what was and was not permitted, the DOL published a renewed statement that social factors could not supplant the financial interests of the members and beneficiaries. The Labor Department had issued an Interpretive Bulletin in 2008 (IB 2008-01, codified at 29 CFR 2509.08-01) which was to clarify fiduciary consideration of collateral, non-economic factors was appropriate. Since that time, the DOL has observed that its guidance may have dissuaded fiduciaries from ESG and ETI factors when financial considerations were otherwise equal.

In the final analysis, societal factors may be considered when economic impact is substantially equivalent to non-ESG factors. The unanswered question is how a plan addresses such considerations in the aggregate. In other words, if one or two divestments do not cause a financial impact but a combination of several such actions do, then the trustees must take such a collective impact into account. **http://federalregister.com/a/2015-27146**

IF YOU HAVE ANY QUESTIONS OR COMMENTS CONCERNING THIS PRESENTATION, CONTACT ROBERT D. KLAUSNER, KLAUSNER, KAUFMAN, JENSEN & LEVINSON, 7080 NW 4th STREET, PLANTATION, FLORIDA 33317, (954) 916-1202, FAX (954) 916-1232, WEBSITE, www.robertdklausner.com.