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FIDUCIARY DUTIES HOW ROLES AND RESPONSIBILITIES ARE CHANGING UNDER INCREASED SCRUTINY

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I. FIDUCIARY DUTY - A DEFINITION

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.

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2. Exercise of discretion is the key.
3. Can include more than just the trustees.
4. Extends to investment management and consultants.

B. Judicial Standards

1. Meinhard v. Salmon, 164 NE 545 (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. LOUISIANA'S DEFINITION OF FIDUCIARY

A. Statutory Authority

1. 11:261, et seq., LRS sets forth fiduciary standards
2. Fiduciary integrity deemed essential to the maintenance of prudent retirement programs. 11:261, LRS
3. Prudent person rule applied to all state and statewide retirement plans. Defined as the exercise of reasonable care, skill and caution that a prudent institutional investor would apply in like circumstances. Also known as the prudent expert rule. 11:263, LRS

4. Any person exercising discretionary control over plan assets or who advises on investment matters for a fee is a fiduciary. 11:264, LRS
5. A fiduciary must discharge his or her duties for the exclusive benefit of the members and beneficiaries of the plan. 11:264.3-4, LRS. However, simply choosing an investment that declines in value is not actionable, if the decision was the product of reasonable due diligence.
6. Co-fiduciaries jointly liable. 11:264.6, LRS. This means that if one trustee is aware of a breach of fiduciary duty, there is a duty to disclose. In addition, the statute recognizes that the Board acts as a whole, like a corporate board of directors.
7. 11:265 makes trustees individually and personally liable for a breach of fiduciary duty.
8. Investment standards are established by statute. 11:266, LRS
9. In 2005, additional disclosure for investment managers added relating to compensation. 11:269, LRS

III. CONSTITUTIONAL ISSUES

A. Impairment of Contract

1. Both the US and various state constitutions make pension benefits a constitutionally-protected property right.
2. The degree to which legislation may affect current employees varies from state to state.
3. No federal regulation of this issue because of 10th Amendment federalism concerns.

B. Application of ERISA standards

1. ERISA prudent investor standards have specifically been made not applicable to state plans.

2. Congress determined that the reserved powers clause of the 10th Amendment of the constitution prevented federal regulation of this traditionally state concern.

C. Louisiana Constitution

1. Article X, Section 29
2. Incorporates contract theory
3. Plan changes for new hires are within the discretion of the Legislature. Alteration of benefits for current members of a retirement system must be scrutinized for their impact on constitutionally protected contract rights.

4. Pending National Fiduciary Issues of Interest in Louisiana

Role of trustees in benefit reduction issues

Funding Issues

Effects of Political Divestiture

Market value of liability standards

Constitutional Protection of Benefits

D. Where Does the Legal Duty to Act Lie?

1. Trustees have a duty to secure full payment of all contributions owed to the Fund.
2. Trustees have a duty to enforce the provisions of the legislation as written. If legislation proves to be unwise, it is a matter for the Legislature to resolve. Louisiana courts have enforced the rights of retirement plans to secure their assets and income streams from interference.
3. Trustees have a duty to adopt sound actuarial and investment policies designed to protect the interests of the members and beneficiaries of the System.

Louisiana Supreme Court upholds constitutionality of statutes permitting actuarial committee to set the employer contribution rate.

Several cities, represented by the Louisiana Municipal Association, filed suit against the Louisiana Firefighter Retirement System requesting a declaration that the employer contribution rate to the system was statutorily fixed at 9% and seeking an injunction preventing the state and the system from demanding more than the fixed 9% contribution rate. The lower court held the statutory provisions providing for funding of the system were unconstitutional as applied. The Louisiana Supreme Court affirmed in part, reversed in part, and dissolved the injunction. The court held that employers participating in defined benefit retirement systems could not avoid their constitutional duty to fund the retirement systems according to their actuarial need. Even if the cost was a burden on the employer, the solution was in the legislature, not the courthouse.

Louisiana Municipal Association v. State, 893 So.2d 809 (La. 2005)

IV. LIMITATIONS ON THE ABILITY TO ALTER CONTRACT RIGHTS EVEN IN CRIMINAL MATTERS

A. Act 634

In the 2010 Legislative session, Louisiana retirement systems led a successful campaign to substitute a reasonable program of garnishment of pension benefits to provide restitution for crimes committed while in public service.

The bill amends various provisions of Title 11, LRS, primarily 11:292, and provides for garnishment for fines and other court-ordered restitution for felonies committed after July 1, 2010.

Unlike a forfeiture, which would have required a constitutional amendment, garnishment is already permitted for community property and other divorce-related matters and for federal income taxes. This permits courts to fashion an appropriate remedy which does not interfere with community property rights nor does it result in a

punishment to the member which may be wholly disproportionate to the offense committed.

The Board will also be spared the expense of determining whether an offense was appropriate for forfeiture. Instead the criminal courts, which operate under the highest standards of proof and due process will determine the penalty and the Fund will administer the order in the same manner as a domestic relations order.

B. The Federal Government has its own forfeiture process

Two LSPRF plan participants and the plan appealed the trial court's ruling that the United States may garnish the participants' pension benefits. The plan participants pleaded guilty to violations of federal laws and the trial court ordered the participants to pay restitution. The United States filed motions for writs of garnishment under the Federal Debt Collection Procedures Act (FDCPA) in an effort to seize the participants' retirement interests, and the district court issued writs of garnishment to the Louisiana Sheriffs Pension and Relief Fund (LSPRF). The appellants argued that the United States cannot legally garnish pension benefits pursuant to the Mandatory Victims Restitution Act (MVRA) because (1) Section 401(a)(13) of the Internal Revenue Code makes pension benefits inalienable; (2) forfeiture of the benefits is precluded by the Tenth Amendment to the United States Constitution; and (3) Louisiana constitutional and statutory law exempts pension benefits from garnishment. The court held that (1) "[n]otwithstanding any other Federal law" language in the MVRA overrides the anti-alienation provision of the Internal Revenue Code; (2) the garnishment does not violate the Tenth Amendment because it has no effect on state law, but rather penalizes violations of federal law; and (3) to the extent state law is inconsistent with the FDCPA and MVRA, state law is preempted. Finally, the LSPRF argued that it may be subject to liability for issuing a return of contributions without receipt of the statutorily required application. The court rejected the LSPRF's argument that it may be subject to double liability by reasoning that Section 3206 of the FDCPA insulates it from such liability.

United States of America v. DeCay, 620 F.3d 534 (5th Cir. 2010)

V. FIDUCIARY LIABILITY

A. Limits of Exposure

As public officers, trustees have some measure of sovereign immunity. Generally, public officials are not subject to personal liability unless they act willfully, wantonly and in reckless disregard of human life, safety and property.

B. Types of Claims

Claims against retirement plans fall into several categories.

1. Contract Claims

The great majority of claims for denial of benefits are contractual in nature. Denial of benefits in essence involves an interpretation of the pension contract. Therefore contract law applies and damages are limited to providing the benefit which was denied together with interest.

2. Civil Rights Violations

Failing to provide a plan member with a due process hearing before action is taken to deny benefits can result in a civil rights claim under the provisions of the federal Civil Rights Act of 1871, 42 USC §1983. This means that a member has been deprived of property rights (contract rights) without due process of law. Such claims can result not only in a make-whole remedy but also compensatory damages associated with the loss of the contract right. Punitive damages are not available against a state.

3. Tort Claims

It could be argued that if a member was misled as to rights under the plan through negligent misrepresentation that the fund could be sued for its negligence in explaining those benefits. The leading Louisiana case on pre-retirement counseling is Durand v. Board of Trustees of the Sheriffs Pension & Relief Fund, 704 So.2d 12 (La. App. 1 Cir. 1997). In

Durand, an employee misunderstood the summary plan description despite being advised to the contrary. The court found that any misunderstanding was solely the fault of the employee and found no liability on the part of the fund. The greater likelihood of a negligence claim is one which would arise from the negligent management of plan assets. While ERISA provides for liability exposure to trustees of private sector plans, such negligence claims against a government plan could be argued to fall within the state's governmental immunity statute. This would mean that employees and officers sued for negligent activity would be entitled to a defense and indemnity by the entity. Prior actions against the Board members have been dismissed under the state sovereign immunity statute. General immunity under 42:1441.1, LRS; 9:2798.1, LRS.

4. Planning for Risk Avoidance

Risk avoidance is in most instances simply good advance planning. In a case for avoiding claims for denial of benefits arising out of evidentiary hearings, it is important to have a written due process procedure. The due process procedure should provide notice, an opportunity to be heard and set forth a standard of proof. Trustees who will be deciding contested issues should not discuss the matter with the applicant or any other interested person prior to a hearing. All decisions should be based solely on the evidence presented at a hearing and the law applicable to the claim. All administrative orders and decisions should be reduced to writing setting forth in detail the reasoning of the trustees for their decision.

VI. ADMINISTRATIVE ISSUES

A. Policy-Making

Administrative agencies of government have the authority to make policies and procedures to interpret and apply the statutory authority under which they are created. Administrative rules may not exceed or grant powers not provided for by statute.

B. Ethics Rules

It is particularly important that trustees and fiduciaries of a retirement system avoid the appearance of impropriety. Under ERISA, there is a comprehensive set of prohibited transactions. No similar set exists for government plans. It is therefore important for the Retirement Board to identify conflicts of interest and address them. The general rule to follow is that "if it seems like it is wrong, it probably is."

C. Dealing With Vendors of Services

The area most fraught with potential conflicts of interest is dealing with providers of services to the retirement plan. Given the public scrutiny under which fiduciaries of government plans operate, it is best to avoid even an appearance of impropriety. This can be as simple as acceptance of a gift or gratuity which might otherwise be deemed an innocent gesture of friendship. It would be appropriate for the Board to adopt a policy regarding the acceptance of meals and other gratuities from vendors and to provide for a system of reporting. Further, it is extremely important that the fiduciaries of the Plan avoid direct contact with vendors during any hiring process. All communication should be through administrative personnel to avoid a suggestion or appearance that a contract for service has been awarded on anything other than the basis of merit. Reducing these rules to writing and providing for a method of reporting creates strong evidentiary support of the Board's adherence to important fiduciary principles of fair dealing. It should also be remembered, that the lowest fee is not equal to the best performance. In choosing asset managers, the fund should focus on expected return as that will substantially outweigh most differences in manager compensation.

D. Limits on Trustee Authority

Trustees are part of the executive branch of the government. They lack the authority to alter the plan document. Only the Legislature may change the terms of the plan. The trustees have broad powers to administer and interpret the plan and the applicable legislation. They may not, however, ignore the plain language of Title 11, LRS. The Civil Code teaches that the sources of law are legislation and custom. Legislation is the primary source. Words must be given their plain and ordinary meaning.

VII. 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 an example of “best practices” and reflects the policy adopted by Louisiana retirement systems:

1. As the Plan is responsible for management of its own assets, the following procedures are 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.) The policy is also to be reviewed by counsel to insure compliance with the law and fiduciary legal standards.
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.

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 test transactions by scientific sampling to determine compliance with government accounting standards to check for any system weaknesses which may be observed.
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. The Plan will periodically issue a summary of relevant plan provisions to plan participants. While the summary is intended to be a useful tool, the only binding authority are the statutes governing the Plan.

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. The prudent investor rule is codified in Louisiana in 11:263, LRS.

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 severable without cause and without notice so that prompt action may be taken with regard to an underperforming investment manager. In the case of the TRSL, a chief investment officer performs a more in depth level of due diligence on behalf of the Board as a whole. The Board may reasonably rely on the report of the investment committee following a detailed presentation summarizing their due diligence.

VIII. PENSION REFORM - WHAT IS THE BOARD'S ROLE

A. Trends

Over the past several years the debate concerning the future and design of public employee retirement plans has intensified. Recent examples are provided below of retirement systems switching from DB to DC, or adding separate DC options.¹ A small number of

¹ Overview of Plan Types and Their Use Among Statewide Retirement Systems, NASRA, April 2007, Exhibit "2"; *Defined Contribution Experience in the Public Sector*, Mark C. Olleman, Benefits & Compensation Digest, February 2007.

examples are provided of a closed statewide DB plan being reopened for members forced into the DC plan and the creation of hybrid plans established alongside existing DC plans.

In the corporate, private sector environment, a clear trend of defined benefit plan closing has emerged. It is unclear whether or not this trend will play out in the public sector. On balance, to the extent that a trend can be identified in the public sector, DC alternatives/hybrid and/or cash balance plans are being created within and alongside DB plans.²

In 2005, the State of Alaska closed its DB plan for all state employees hired after June 2006, leaving the Alaska Railroad Retirement Plan as the only open public employee DB retirement system in the State of Alaska. The state DB plans continued for existing members. The Municipality of Anchorage maintains a closed DB plan for its public safety employees. It is considering re-opening this plan to enhance recruitment opportunities. A bill is pending in the Alaska Legislature to re-open the state DB plan.

In 2004, California Governor Arnold Schwarzenegger proposed closing California's DB plans in favor of the creation of a new DC system for future employees. After vocal opposition by labor and employee groups, the Governor withdrew his initiative proposal. Earlier this year, the California Foundation for Fiscal Responsibility proposed a less ambitious proposal which would leave existing DB

2 It should be recognized that public sector/governmental DB plans have at least three comparative advantages over their private sector counterparts. First, private sector plans are required to participate in the Pension Benefit Guarantee Corporation (PBGC) insurance program and make insurance premium payments to the PBGC. As a result, corporate DB plans have moderately higher costs, since well managed plans are required to pay insurance premiums based on the liability of other less well managed plans. Second, governmental DB plans are not subject to the "going concern" default scenario facing private sector employers. The risk that a private employer will go out of business is a fundamentally different risk which does not exist for public DB plans. Third, governmental plans are permitted a degree of actuarial flexibility which is not available in the private sector. For example, governmental DB plans are not forced to periodically change their liabilities based on interest rate levels, which results in greater contribution volatility for private sector plans.

plans intact, but impose benefit limitations and benefit caps.³ The proposals have considerable constitutional impediments.

In 2004, Colorado established a DC option for new state employees beginning on January 1, 2006.

In 2003, Oregon created a hybrid plan for new Oregon employees in lieu of the traditional DB plan. The hybrid plan uses a 1.5% DB multiplier (1.8% for public safety) funded by the employer, along with a mandatory employee contribution into the DC plan.

In 2002, Nebraska established a hybrid cash balance plan for new state and county employees and existing DC plan participants electing to switch into the new cash balance plan. The hybrid plan was created in response to concerns that employees were not accumulating enough retirement savings in the stand-alone DC plan.

In 2002, members of the Montana PERS were given the option of switching from the state's DB plan into a DC alternative during a one-year open enrollment process. Approximately 3% of eligible employees elected to transfer to the DC plan.

In 2000, Florida modified its traditional DB system to give FRS participants the option to move into the newly created Florida Investment Plan, a DC alternative.⁴ After spending \$89 million to set up these DC accounts, initially fewer than five percent of eligible participants opted to move into the new FRS DC program.⁵ Since

3 The California Foundation for Fiscal Responsibility's press release, Exhibit "16", is available at www.californiapensionreform.com/initiative_press_release.htm; a copy of the 2007 initiative, Exhibit "17" is available at www.californiapensionreform.com/initiative_text.htm

4 The FRS Investment Plan is also known as the Public Employee Optional Retirement Program, a 401(a) DC plan that employees may select in lieu of membership in the traditional DB plan, the FRS Pension Plan.

5 Florida State Board of Administration Fact Sheet, *Update on Choice in the Florida Retirement System*, March 31, 2007, <http://sbafla.com/pdf/news/Update%20on%20Choice.pdf>.

2002, the track record has been better and more new hires have begun electing the state's DC plan.⁶

Beginning in 2000, South Carolina teachers and educational employees were given the option to participate in a DC plan as an alternative to the state's DB plan. The option was extended to other state and local government employees in 2002. Approximately 17% of employees elected to switch to the DC plan.

In 1998, Ohio created an optional DC plan for new educational employees not yet vested in the state DB plan. Eligible employees were given three options, remain in the DB plan, or switch to a DC plan, or a hybrid plan. The options were subsequently extended to teachers in 2001 and local government employees in 2002. Approximately 95% of active employees elected the DB plan or the hybrid plan, with the vast majority electing to remain in the traditional DB plan.

West Virginia closed its teachers DB plan in 1991, requiring all new teachers to join a new DC plan. According to an actuary for the West Virginia teacher retirement system, the new private account system was more expensive than the old DB pension system. The actuary for West Virginia also found that switching back to a traditional DB pension system would save taxpayers millions of dollars annually in pension contributions. As a result, West Virginia switched back to a traditional DB plan in 2005. Participants in the DC plan switched en masse to the reopened DB plan.

At the time West Virginia switched back to a DB plan, only 105 out of 1767 teachers over age 60 had a DC account in excess of \$100,000. An account that size would yield a monthly annuity of approximately \$600 beginning at age 65. The average balance was just under

6 Florida State Board of Administration Fact Sheet, *Update on Choice in the Florida Retirement System*, March 31, 2007, Exhibit "18", pages 3-4. On an annual basis, the percentage of new employees electing the Florida Investment Plan has ranged from 8% in 2003 to 21% in 2006. During the first quarter of 2007, 26% of new hires elected the FRS Investment Plan and 74% elected or defaulted into the FRS Pension Plan. Of the total of 695,622 FRS members on March 31, 2007, 89% were participating in the FRS defined benefit Pension Plan and 11% were participating in the defined contribution Investment Plan.

\$42,000, a sum which is incapable of supporting any meaningful retirement.⁷

In 2010-2011, more than 30 states adopted legislation limiting or repealing defined benefit plan provisions. As a result, numerous suits are pending in state and federal courts challenging those changes. The changes focus primarily on lower tiers of defined benefits for new hires, something Louisiana has already addressed. Other changes have resulted in limitations on cost of living benefits to current employees and retirees. Those changes have been judicially challenged.

Following the economic devastation of Hurricanes Katrina and Rita, Louisiana considered the elimination defined benefit programs for future employees, but ultimately rejected the idea. The Legislature relied on a 2005 report from the Public Affairs Research Council, a non-partisan research and public advocacy group which concluded:

Nearly all states use DB plans as their primary pension plans. A DB plan is the appropriate vehicle for providing most public sector pensions. It encourages career employment and public employees are less mobile than private sector workers. The DB plan can provide better benefits than an equally funded DC plan, because a pension system can spread risk and invests more effectively than most individuals, who tend to invest more conservatively. The DB plan provides security whereas a DC plan would leave employees vulnerable. Recent studies show that employees tend to cash out their DC accounts, fail to reinvest the with new employer's plan and spend lump-sum distributions, leaving them much reduced retirements. The DC plan serves well for certain short-term positions and as a

⁷ Levitz, J, "When 401(a) investing goes bad: Teachers in West Virginia offer a valuable lesson for what not to do" *The Wall Street Journal*, August 4, 2008.

supplement to a DB plan, but is inadequate as a general primary pension plan. ⁸

B. Cost Considerations

Based on NCPERS' national statistics, on average, governmental employers contribute less than 26 cents for every dollar paid out in DB pension benefits. The remainder is funded by investment income and employee contributions. Most state and local workers are required to pay employee contributions into their public DB pension plans, which is not the case for corporate DB plans.⁹

Closing a DB plan does not result in immediate cost savings. According to Government Accounting Standards Board (GASB) accounting rules, plan sponsors are required to accelerate the funding of benefits in a closed plan. The actuarial methodology would necessarily change in a manner which accelerates the payment of plan liabilities over a shorter period, resulting in a spike in employer contribution rates. Since new employees are no longer participating in the closed DB plan, their salaries will no longer be included as a basis for making contributions to amortize the existing UAAL (unfunded actuarial accrued liability) amount. Thus, employer contributions to the UAAL will be paid out as a percentage of salary for a declining group, resulting in a higher employer amortization payment.¹⁰ Additionally, offering a DC and DB option may increase costs due to adverse selection. Informed employees should opt for the program they anticipate will best match their career plans. As a

8 *Public Employee Retirement, Time for Change.* Public Affairs Research Council of Louisiana, Analysis No. 306, Baton Rouge, La. 2005.
<http://www.la-par.org/Publications/PDF/RetirementReport2005.pdf>

9 NCPERS fact sheet 1, *Traditional Pensions: A Tried & True System that Benefits Taxpayers.*

10 Milliman study for Los Angeles County, forth in March 2, 2005 letter to Marsha Richter, Chief Executive Officer for the Los Angeles County Employees Retirement Association (LACERA).

result, the average entry age in the DB plan may increase while actuarial savings due to turnover may decrease.¹¹

In 2005, when the State of California was considering closing its DB plan in favor of a DC plan for new employees, the transition cost was estimated at \$7.6 billion.¹² Under the most optimistic assumptions, it was projected that cost savings would not be realized for at least 10 years. In the case of Los Angeles County, a March 2005 actuarial study found that the county would not see any net savings for over 20 years, in 2028.¹³ The first annual savings would not occur until 2019/2020. The Los Angeles County study further found that the required County contribution rate would increase by 4.85% of pay.

Stated mathematically, $\text{Benefits} = \text{Contributions} + \text{Investment Earnings} - \text{Expenses}$. Greater benefits can only be gained by higher contributions, greater earnings or lower expenses. According to a study performed by the defined benefit Kansas Public Employees Retirement System, any conversion to a DC plan needs to address the current low level of DC contributions. The assumption that superior investment returns can consistently be earned by DC participants “contains the seeds of grave danger for future Kansas retirants and taxpayers.”¹⁴

11 *Study of Retirement Plan Designs for the State of Colorado Office of the State Auditor*, Buck Consultants, November 2001.

12 NCPERS fact sheet 1, *Traditional Pensions: A Tried & True System that Benefits Taxpayers*.

13 The Milliman study is set forth in a letter to Marsha Richter, Chief Executive Officer for the Los Angeles County Employees Retirement Association (LACERA) dated March 2, 2005.

14 *Plan Design: A Review of Current Public Pension Issues*, Kansas Public Employees Retirement System, January 2000.

Increasingly, public employers are being urged to use caution in making changes to their retirement programs in response to the current economic conditions.¹⁵

The primary purpose of municipal government is to provide for the safety and welfare of its citizens. More than any other level of government, the cities, counties, and states meet the immediate needs of its citizens for the most basic security - fire protection and emergency medical services. To ensure the continued high level of public security that citizens have come to expect, and employer's benefit program must remain competitive. Material changes in the current programs will take employers out of a competitive position in the relevant labor market and will make its public safety force, particularly among less tenured employees, vulnerable to competing offers.

A prudent pension board must be committed to the efficient administration of the plan in accordance with expected fiduciary standards. It must be keenly aware of the need to conduct business in a fiscally-responsible manner which maximizes return with a reasonable level of risk on investments. This will, over time, lead to the decline in employer contributions without any loss of employee benefits or plan security.

In a recent article, the *Journal of Pension Benefits* explores the reasons for the continued resilience of governmental DB plans. Among the reasons for the durability of DB plans in the public sector is the fact that DB pensions "work for taxpayers" by squeezing more value out of each dollar contributed. The author also concludes that DB plans "work for employees" by providing life-long retirement security and stable income for retirees.¹⁶

Participants in 457 plans have seen a 25-30% decline in the value of their deferred compensation accounts. For employees on the verge

15 Boivie and Almeida, "Look Before you Leap : the Unintended Consequences of Pension Freezes," National Institute on Retirement Security, October 2008.

16 Beth Almeida, *DB Pensions: The Real Deal*, The Journal of Pension Benefits, July 2010

of retirement, such a loss would be catastrophic were it not for the security of their defined benefit retirement plan.

It is important to remember that retirement plans operate in 30-year time horizons. Short term reactions to long-term programs are disruptive and ultimately diminish the likelihood of economic success in those plans.

C. Recent Trends in Pension Litigation

In 2010 and 2011, a number of states lowered or eliminated cost-of-living provisions in an effort to improve the funding level of financially-stressed retirement systems. The reductions were challenged by members and retirees as impairing the obligation of contract and depriving members of their property rights without due process of law. In a pair of detailed trial court decisions issued in June 2011, courts in Minnesota and Colorado rejected the constitutional challenge.

The Minnesota case, Swanson v. PERA, was decided using an analysis of Minnesota's promissory estoppel theory which calls for a balancing of legitimate state interests and the rights and expectations of retired plan members. In finding that the reduction of the COLA was not unconstitutional, the Court noted that the legislative history of the COLA provisions indicated that it was intended to be a variable and, therefore, amendable provision. At the same time, however, the Court made it clear that the base benefit was not subject to alteration based on constitutional contract and property principles.

Reaching the same result for surprisingly similar reasons, a Colorado trial court rejected a challenge to a Colorado law altering the COLA provisions of the state retirement system. The Court found that the COLA had been an ever-changing process, unlike the base retirement which the Court found to be protected from diminution or impairment.

In the 2011 Legislature, at least 18 states considered similar reductions in COLA benefits alone. The most highly publicized were reductions by the Rhode Island, New Jersey and Florida

Legislatures. The New Jersey and Rhode Island provisions are particularly controversial in that it creates a committee to decide if the COLA should be reinstated once the retirement plan meets a certain funding benchmark.

This month trial courts in Arizona and New Hampshire rejected statutes which would have increased employee contributions with no offsetting new advantage. The court found that making employees pay more for what they had already been granted was an impairment of the obligation of contract. These cases, when compared to the Colorado and Minnesota cases demonstrate the extreme state of flux in which employees benefits operate today.

Numerous bills are pending in Louisiana which also implicate the constitutional rights of participants under Article I, Section 23 and Article X, Section 29 of the Louisiana Constitution. It is expected that the proposed legislation will meet similar vigorous constitutional challenges in the courts.

D. The Duty of Trustees in Plan Design Discussions

1. What is not the trustees fight?

Trustees do not have a constituency of management or labor. Their sole constituency is the best interest of the members and beneficiaries of the System. Collection bargaining is a matter between employee organizations and employers. Trustees of a retirement system have no role in that process. Whether benefits should be increased or decreased is a matter between the participants and the state.

2. What is the trustees fight?

Louisiana law is clear that fiduciaries have a duty to protect the System for the benefit of the members and beneficiaries. Changes which would weaken the financial status of the System or interfere with its efficient administration are the responsibilities of the trustees to challenge. As always, the timely collection of contributions is a primary duty. The efficient investment of System assets is also a responsibility

which the trustees which must be safeguarded. Plan design changes which will result in adverse financial consequences to the System give rise to a duty on the part of trustees to report those potential adverse consequences to the Legislature and to advocate for their elimination.

IX. CONCLUSION

IF YOU HAVE ANY QUESTIONS OR COMMENTS CONCERNING THIS PRESENTATION, CONTACT ROBERT D. KLAUSNER, ESQUIRE, KLAUSNER, KAUFMAN, JENSEN & LEVINSON, 10059 NW 1ST COURT, PLANTATION, FLORIDA 33324, (954) 916-1202, FAX (954) 916-1232, EMAIL bob@robertdklausner.com, WEBSITE: www.robertdklausner.com