BEST PRACTICE

Governance of Public Employee Post-Retirement Benefits Systems (2010) (CORBA) (new)

Background. Public employee post-retirement benefit plans (e.g., retirement plans and other post employment benefits (OPEB) trusts) are typically established by state and/or local law and are governed by boards of trustees (boards, governing boards, trustees) that are subject to legal constraints. In addition to any duties set forth by statute, trustees of post-retirement benefit funds are bound by fiduciary duties, which can be divided into three categories:

- Duty of loyalty – The obligation to act for the exclusive benefit of the plan participants and beneficiaries. The trustees must put the interest of all plan participants and beneficiaries above their own interests or those of any third parties. Regardless of their selection process, fiduciaries must be reminded that they do not represent a specific constituency or interest group.
- Duty of care – The responsibility to administer the plan efficiently and properly. The duty of care includes consideration and monitoring of the financial sustainability of the plan design and funding practices.
- Duty of prudence – The obligation to act prudently in exercising power or discretion over the interests that are the subject of the fiduciary relationship. The general standard is that a trustee should act in a way that a reasonable or prudent person acts in a similar situation or in the conduct of his or her own affairs.

Criteria for selection of most boards of public post-retirement benefit plans are normally set by state statute or other authority that establishes the plan. Governing fiduciaries set strategy and policy, determine decision-making authority, and delegate day-to-day management of the retirement system. Proper board structure and clarity of board roles and responsibilities that are consistently and fairly enforced promote good governance and provide legal protections for both plan fiduciaries and plan participants. Through prudent management, trustees, individually and collectively, must act in the best interest of all plan participants and beneficiaries.

Recommendation. The Government Finance Officers Association (GFOA) recommends that the state or local government or other designated governing entity establish rules of governance for its post-retirement benefit systems that define the key elements necessary for trustees and other fiduciaries to fulfill their responsibilities, in accordance with fiduciary standards. The following governance best practices are recommended:

1) Governance Manual – Adopting and maintaining a written governance manual enables good governance. At a minimum, this manual should include:

    a) An outline of the authority under which the system operates.
    b) A section outlining the roles and responsibilities of the board of trustees, administrator (director or executive director), and staff.
    c) All board-adopted policies and any applicable statutes, regulations, and other relevant documents.
    d) A description of all permanent (standing) committees, with a copy of the committee charter.

2) Governing Boards:

   a) Size of Board – The post-retirement benefit system's board of trustees should be neither so large as to be unwieldy nor so small that it runs the risk of not being able to get a quorum to make decisions. Optimal board size is between seven and 13 members, depending on the size and complexity of the system.
   b) Board Composition – Any board that operates effectively includes members who have a mix of skills, competencies, and behaviors, including leadership, teamwork, communication, planning and organizational abilities, and knowledge of sound decision-making principles. A successful board actively pursues and makes use of these skills and behaviors. Board composition should reflect the varied interests of those responsible for funding the plan and should include plan participants and retirees, citizens of the governmental unit, and officers of the plan sponsor, as well as independent directors. This assures balanced deliberations and decision making.
   c) Board Education – New trustees must receive orientation training explaining their responsibilities and fiduciary duties as well as the duties of the system's staff and agents (e.g., actuaries, attorneys, advisors, and fund managers). A program of continuing education must be developed, and participation should be strongly encouraged or required.

3) Governance Policies:

   a) Code of Ethics – Every governing board should adopt a code of ethics to provide standards of conduct for board members and plan staff. The code of ethics should, at a minimum, address:
      i) Loyalty. Public fund fiduciaries must make all decisions in the best interest of system participants, placing those interests above all other interests.
      ii) Decision making. Decisions must be made in a fair, honest, and open manner, with information shared among fellow fiduciaries and all interested parties to enhance the quality of the system's decision-making process. Policies should discourage fiduciaries who are plan participants from voting on matters that advance their personal financial interests, and should provide a mechanism for independent trustees to vote separately on such matters if a conflict of interest affects multiple members.
      iii) Personal Conduct. Every public system's fiduciaries, including those who are under contract to provide services to the system, must take all reasonable steps necessary to ensure a full and accurate understanding of the trust, conflicts of interest, financial disclosures, and other ethics-related laws that apply to the system. They must conduct their official and personal affairs to ensure that they cannot be improperly influenced in the performance of their duties.

      iv) Relationships with Others. To foster trust and limit practices that create the appearance of conflicts of interest, plan sponsors should consider including restrictions in their code of ethics on the following behaviors:
         (1) Former employees and trustees soliciting business from the plan for a specified period of time.
         (2) An employee or trustee accepting contributions or material gifts from current or potential business partners, their agents, or their representatives.
         (3) Payment of finder or incentive fees to third-party marketers or other consultants for new or increased business, without full and advance disclosure and other controls where appropriate.
         (4) Any action that would bring into question the independence of the board or staff or the propriety of the system's decision making.

   b) Succession Planning – To ensure continuity of governance, there must be a policy for transition of leadership.

c) Investment Policy – The board must develop a comprehensive set of policies and procedures for investing and safeguarding plan assets. (See GFOA Best Practice, *Public Employee Retirement System Investments*, 2009.)

d) Professional and Contractual Services – The board must have policies and procedures for selecting agents such as actuaries, attorneys, auditors, advisors, and fund managers. These policies and procedures must encourage an open process free of actual or perceived bias and conflicts of interest.

e) Procedures for Monitoring Policies – Policies and procedures must be implemented to allow the board of trustees to monitor whether the board policies are being fulfilled, and whether the roles and responsibilities delegated to the various agents regarding the day-to-day management of the post-employment benefit system are being carried out effectively and to the board's satisfaction.

References.

- An Elected Official's Guide to Public Retirement Plans, GFOA, 1997.
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- National Association of State Retirement Administrators (NASRA) Resolution 1999-06 - Code of Ethics.
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- International City County Management Association Code of Ethics, 2004.
- GFOA Best Practice, Ensuring the Sustainability of Other Postemployment Benefits, 2007
- GFOA Best Practice, Essential Design Elements of Defined Benefit Pension Plans, 2008.
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- Governance Manual, Public Employees' Retirement Association of Colorado.
- *Best Practices for Trustees and Pension Systems*, American Federation of State County and Municipal Employees (AFSCME), available at www.afscme.org/issues/27459.cfm.

Approved by the GFOA's Executive Board, March 5, 2010.