

A
Position Paper
On the Application of the
Fiduciary Duties of the
Stanislaus County
Employees' Retirement Association
Board Members

Prepared For:
Stanislaus County
Employees' Retirement Association's Board

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Executive Summary

The Stanislaus County Board of Supervisors, the CEO's Office and County Management (hereafter referred to as "County") have asked the StanCERA Board to eliminate supplemental benefits for StanCERA retiree members and make the excess revenue funds available to offset the County's retirement contribution rates. In my previous position paper, on Supplemental Benefits submitted to the StanCERA Board on April 17, 2009, I discussed many of the reasons for the County's current financial problems and that to date they have done nothing to mitigate their problems. The previous work is foundational for discussion of the StanCERA Board's fiduciary duties.

I am not taking a position on whether or not the StanCERA Board can eliminate or alter supplemental benefits. However, I am taking a position on whether or not the StanCERA Board is meeting their fiduciary duties when deciding the following:

- Should existing supplemental benefits be modified?
 - Reduce or eliminate healthcare benefits
 - Reduce or eliminate COLA
 - Etc.
- How should excess revenues be distributed today and going forward?
 - Provide benefits for retiree members
 - Provide benefits for active members
 - Provide retirement contribution relief for the County
 - Retain excess revenue funds for future member needs
 - Etc.
- Are there any StanCERA Board Members with a "Conflict of Interest" in making any or all of these decisions?

The StanCERA Board, individually and collectively, must remember that while they are conducting business for the Stanislaus County Employees' Retirement Association they:

- Must abide by all the laws that govern StanCERA
- Must act in the best interest of all StanCERA members (active, retired and deferred) as well as their beneficiaries, today and tomorrow
- Must use their diverse experiences in other aspects of their personal and professional lives to guide them in making decisions that are in the best interest of StanCERA members
- Must NOT act or vote on any issue that has the potential of being a "Conflict of Interest"
- Cannot put the interest of a third-party or themselves before their fiduciary duties to the StanCERA

These are not guidelines; they are the law.

Excess Revenues

The law has specifically defined excess revenues, to give a retirement board the ability to balance benefits in a fair and equitable manner for the benefit of its members, today and tomorrow. This includes the ability to adjust benefits for members that may NOT have been compensated on a par with other members or members that have been adversely affected by changes in the economy (i.e. periods of high inflation). This also includes the ability to offset contributions of active members (either prospectively or retroactively). As long as a retirement board uses the excess revenues to benefit members, they are in compliance.

The law and Mr. Leiderman also support looking at a spectrum of time (past, present and future) and equity of benefits across that spectrum. Please review the video for his discussion of "Inter Generational Equity" (he did not provide a slide or reference material).

Fundamental Fiduciary Duties

Mr. Leiderman stated that the "Fundamental Fiduciary Duties" of the StanCERA Board are:

- Exclusive benefits rule
- Duty of loyalty – best interest of *all* members and beneficiaries, today and tomorrow
- Duty of prudence – to provide sound actuarial funding of promised benefits and independent judgment

Measure of prudence: "under the circumstances then prevailing"

Even though this is a short list, it is still a very compelling list. There is some room for interpretation and inference, but very little. All StanCERA Board members must act in the best interest of members and use independent judgment while considering prevailing circumstances. How does this play out with issues currently being faced by the StanCERA Board?

The County's Request

The County has requested that the StanCERA Board stop providing supplemental benefits to retiree members and apply the excess revenue funds towards the County's retirement contribution rates. Before the StanCERA Board can comply with any such request, they must first evaluate what is in the best interest of all members by determining:

- Who will benefit
- Who will be harmed
- To what degree will each member group be affected

Retiree and active members will be affected the most by this request and deferred members could be affected in the future. At this point we know that retiree members, on a fixed income, would take an average hit in excess of

18.7% and many will be financially hurt by a much larger percentage. The County has NOT provided the StanCERA Board with any information on what the affect will be on active members. Without this information **(in detail)**, the StanCERA Board cannot make a decision that is in the best interest of **all** members because it will not be an informed decision. The decision will strictly be for the benefit of the County who is not a member or beneficiary of the retirement system, thus a decision which is not informed would violate a Board Member's fiduciary duty to make decisions for the exclusive benefit of the members.

For example, let us say that no individual active member will be negatively affected by more than 3%. Is the StanCERA Board working in the best interest of all members they represent?

By negatively affect 18.5% of members by over 18.7%
while negatively affecting 63% of members by only 3%
and negatively affecting the remaining 18.5% by something less than 18.7%.

The StanCERA Board has a duty to represent and treat all members fairly. If active members are affected by only 3%, then all members should be affected equally and no one member group should bear the entire weight. The StanCERA Board **MUST** protect the interests of the retiree members because they are not protected by a bargaining unit, MOU or any other group that must be negotiated with like active members. The StanCERA Board would fail to meet their fiduciary duties if they fail to protect the interest of all members.

If and only if the StanCERA Board has determined that the best interests of all members are met, then they can consider using excess revenues to reduce the County's contribution rates. I discuss this possibility later.

Excess Revenues – Yesterday, Today and Tomorrow

The use of excess revenues has a history and a future. Part of maintaining integrity as a Board, the StanCERA Board must consider the fair and equitable use of the excess revenues throughout the entire spectrum of time. The StanCERA Board must ask themselves the following:

- How have excess revenues been distributed in the past?
- Were previous distributions fair and equitable at the time?
- Were previous distributions creating equality for members based on other previous distributions?
- Are current distributions still in-line with creating equality for all members?
- Will a proposed distribution
 - be in-line with the existing balance of equality?
 - enhance the existing balance of equality?
 - distort the existing balance of equality?
 - prevent future Boards from maintaining a balance of equality?
- Etc.

A History

Part of the problem facing the County right now is that they increased benefits a few years ago for safety from 2% at age 50 to 3% at age 50. This was a 50% increase in benefits for safety members and these employees did not have to pay for this increased retirement out of their pockets. The County chose NOT to have whatever service the employee had (to date) at 2% remain at 2% and have any future service calculated at 3%. They wanted all of the service at 3%. They also increased the general member's retirement to 2% at age 55 1/2 and did not ask the employees to pay for this with increased contributions.

The County did not have to pay for the retrospective increase in benefits. Reagan Wilson came and asked StanCERA to use the "Ventura" fund of about \$40 million to pay for the retrospective increase in benefits. The StanCERA Board had put aside this money to pay for the Ventura decision or consequences. Now the economy has tanked, in order for the County to meet their contribution obligation and to continue paying for those increased benefits (which cannot be taken away) the County wants the StanCERA Board to look at benefits they can take away from a select group of members (retirees).

The County (specifically the Board of Supervisors) needs to be reminded that even though many faces have changed on their Board, by taking office they also took responsibility for all the promises in place. The Board of Supervisors' predecessors wanted these increased benefits. Just because they are having difficulties paying for them now, is no reason to put that burden solely on the backs of the retiree members.

It is examples like this that the StanCERA Board needs to take note of for a few reasons:

- It is just one example of how the StanCERA Board has helped the County in the past.
- It is an example of how the StanCERA Board has helped the then active member by paying for the retrospective contribution (by crediting the County's account). The active members did not have to pay anything to get the increase in benefits applied to their prior years of service.
- It also shows that the County has set a pattern of looking for bailout after bailout from StanCERA verses doing anything proactive in their own house to resolve their problems.
- It is just one, of several, actions taken by previous StanCERA Boards that should be considered when determining current and proposed excess revenue distributions.
- This example of the distribution of excess revenues, solely benefitted the then active members and gave no benefit to any retiree or deferred member.

The StanCERA Board must treat the distribution of excess revenues to members the same way the actuarial firms try to smooth out the highs and lows in their projections. The distribution of excess revenues must be done on in a fair and equitable way in the best interest of all members, today and tomorrow by considering the past, present and future needs in relationship to past, present and future distribution of excess revenues.

A Future

Mr. Leiderman pointed out that there are occasions when the StanCERA Board can consider the employer's (the County's) situation and actually provide some assistance. Let us say that the following are all true:

1. The StanCERA Board has evaluated all distributions of excess revenues and determined that all members are being dealt with in a fair and equitable manner.
2. There are excess revenues available, above the level needed, to continue to deal in the best interest of all members, today and tomorrow.
3. There appears to be a continued future growth in excess revenues.
4. There appear to be NO foreseeable need to assist any specific group of members for several years.
5. The County has found themselves in a substantial hardship.
6. The County has done everything reasonable to fix their substantial hardship and is coming to StanCERA as a last resort instead of as a quick fix.

If all of the above were actually true, there would probable be few, if any, complaints if the StanCERA Board decided to help the County. However, as far as I can tell, five(5) of the six(6) items listed are FALSE. For example:

1. The StanCERA Board has NOT evaluated the distribution of excess revenues and declared that the used of excess revenues (past, current and future) have been in the best interest of all member in a fair and equitable manner.
2. The StanCERA Board has NOT determined that there are currently excess revenues available beyond those that are currently being allocated in the best interest of all members, today and tomorrow.
3. I doubt that anyone could declare that excess revenues will continue to grow in the near future.
4. Given that almost every economist in the US, including the US President's economist, believe that the current US policies (bailouts, stimulus bills, artificially holding interest rates down, etc.) will create a period of high inflation in the foreseeable future. People on a fixed income will be the sector that is most adversely affected by high inflation and retirees are on a fixed income. It is the current StanCERA Board's duty to protect a future StanCERA Board's ability to insure that all members are fairly and equitably cared for tomorrow.

5. Given the County has NOT yet disclosed exactly what County services will be disrupted and to what degree they will be disrupted, we can only presume, the County has fallen into substantial hardship.
6. Given the County's disclosures to date, we cannot determine if they have done anything, more less everything reasonable to fix their substantial hardship. How much savings would come from terminating all professional service contractors (who are the most expensive and do not contribute to retirement)? How much savings would come from a few furlough days for active employees? How much savings would come from amending the retirement plan for new employees? Have the unions been approached about forfeiting any negotiated raises or cost of living increases? If the retirees have to give up their cost of living increases, why don't active employees (which are both members in the StanCERA plan) have to equally give up this benefit?

Mr. Leiderman stated that the StanCERA Board must apply its fiduciary duties with prudence "under the circumstances then prevailing". Considering the prevailing circumstances identified above, it would NOT be prudent for the StanCERA Board to consider reducing the County's contributions rates at this time. Setting a bar or standard at this level, is what a prudent person would do when protecting the interest of another party.

Conflicts of Interest

Mr. Leiderman is attempting, by his own description, "to clear the minefields for the Board." During his presentation, he discussed the StanCERA Board members' possible conflicts in relationship to setting contribution rates based on actuarial input. He also stated it is not a conflict of interest if the decisions "Don't effect you personally" (this was not listed on his slide). It is easy to see that few, if any, board members would have a conflict here. Given, there is full disclosure of benefits promised by the County and the use of "best practice" actuarial factors (i.e. estimated rates of return, inflation, etc.), the numbers are what they are. It is not a conflict of interest, as long the numbers are not manipulated to benefit anyone.

I think that Mr. Leiderman needs to discuss conflicts of interest in relationship to the primary discussion at hand, which is taking benefits away from retiree members for the purpose of reducing the County's contribution rates. Specifically, he needs to discuss this in light of his statement about decisions that can affect a board member personally (this is not limited to financial benefits). If a StanCERA Board member is also a member of the Stanislaus County Board of Supervisors, it appears to be very apparent that member would be personally affected by this decision. That member does personally benefit if his Stanislaus County Board of Supervisors job is made easier.

Reducing the County's contribution rates with StanCERA's excess revenues would definitely make that member's job easier as a member of the Stanislaus County Board of Supervisors. This member would have his/her burden reduced, as a member of the Stanislaus County Board of Supervisors, by offsetting some of the work needed to perform possible reductions in force, furloughs, reductions in County provided services, negotiating salary reductions, etc. This is clearly a conflict in interest when deciding anything related to decisions that directly or indirectly benefit the County.

It also has the appearance of impropriety, if not an outright conflict, when that Board member, appears to be wearing his Board of Supervisor's hat at the Retirement Board meetings when he is the one pushing for the elimination of these benefits to retired members, who are a group that he is obligated to protect. When he sits on the Retirement Board his obligation is not to the County as an entity but to the members and beneficiaries of the retirement system. If he cannot be independent in his role as a Board of Supervisor member and then as a Retirement Board member he needs to recuse himself from participating in any discussion and vote on that matter, and he needs to reevaluate whether or not he can remain as an independent Retirement Board member or resign completely. When he puts the County's alleged needs (and remember currently there are only claims of such a need and no empirical proof) before the needs of the members and beneficiaries of the retirement plan he fails as a Retirement Board Member and he disgraces the entire Retirement Board and system as a whole.

Conclusion

In preparing this document, I have read the '37 Act, as much case law as possible (i.e. CalPERS v. Wilson, Ventura, Penny, etc.), opinions and articles by firms like Jones Day, etc. The '37 ACT is convoluted to say the least, but there are some obvious themes in the act and case law. Those themes are:

- Retirement Boards:
 - Are distinct legal entities that cannot be controlled or managed by the sponsoring employer (i.e., the County)
 - Have a fundamental fiduciary duty to *only* its members and their beneficiaries, today and tomorrow (exclusive benefits rule)
 - Have a fundamental fiduciary duty to *all* members (active, retired and deferred), today and tomorrow (duty of loyalty)
 - Must provide sound, un-conflicted independent judgment (duty of prudence)
 - Must be fair and equitable to all members in the application of their duties
- Retirement Board member configuration was established to provide a diverse breadth of experiences in other aspects of the Board Members' personal and professional lives to guide them in making decisions that are un-conflicted and in the best interest of there members

- All decisions MUST be evaluated for the ability to withstand the burden of time (Given the “circumstances then prevailing”, does this decision make sense for today and tomorrow?)

All of these are challenges, especially in difficult times, but each and every member of the StanCERA Board has promised to meet these challenges. You must use the autonomy of the StanCERA Board, and your personal and professional integrity to make the right decisions. We are in uncertain times with an uncertain future and this is NOT the time to reduce benefits (without proper analysis) and/or bailout the County. Sometimes the right decision is the hard decision but it must be made. Sometimes the County just needs to be told "NO." This is one of those times.

Respectively, Dennis J. Nasrawi