

CalSavers Retirement Savings Board

Fiduciary and Governance Training

August 22, 2022

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Section 1.

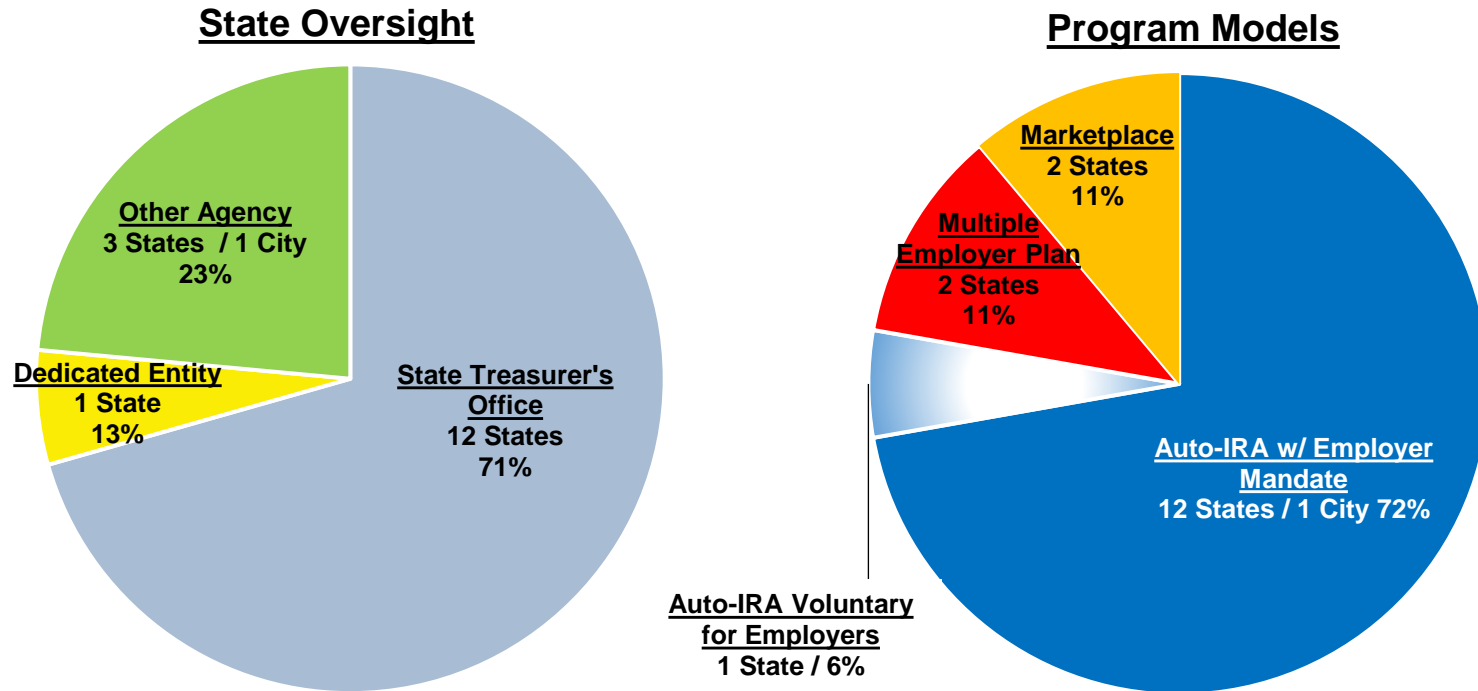
Fiduciary Duties of Administrators

Administrators of State-run Retirement Programs

- **A municipal program is established and maintained by a state instrumentality (either a board or a sole trustee):**
 - State entity acts in a fiduciary capacity
 - State entity is advised by licensed, external experts
 - State entity is an issuer of municipal securities
- **State legislation authorizes each State's Program:**
 - Identifies the administrator
 - Sets the oversight duties and obligations
 - May identify management models as well
- **Governance and oversight vary by the organization responsible for maintaining each Program**

State Oversight and Program Models

- Sixteen States and two Cities have authorized Programs



Information as of July 6, 2022

State Treasurer's Offices include California, Colorado, Delaware, Illinois, Maine, Massachusetts, New Jersey, New York State, New Mexico, Oregon and Vermont. Effective July 1, 2022, it also includes Connecticut through the State Comptroller's Office.

Other Agencies include Hawaii, Virginia, Washington State and City of Seattle. Note that Hawaii is pending Governor's signature.

Dedicated Entity represents Maryland

Oversight reflects 17 Programs, assuming the New York State Program includes New York City Program.

Program Models reflect 18 Programs, including Marketplace and Voluntary Auto-IRA authorized in New Mexico (and assuming New York City is in New York State

State-run Retirement Program Oversight and Governance

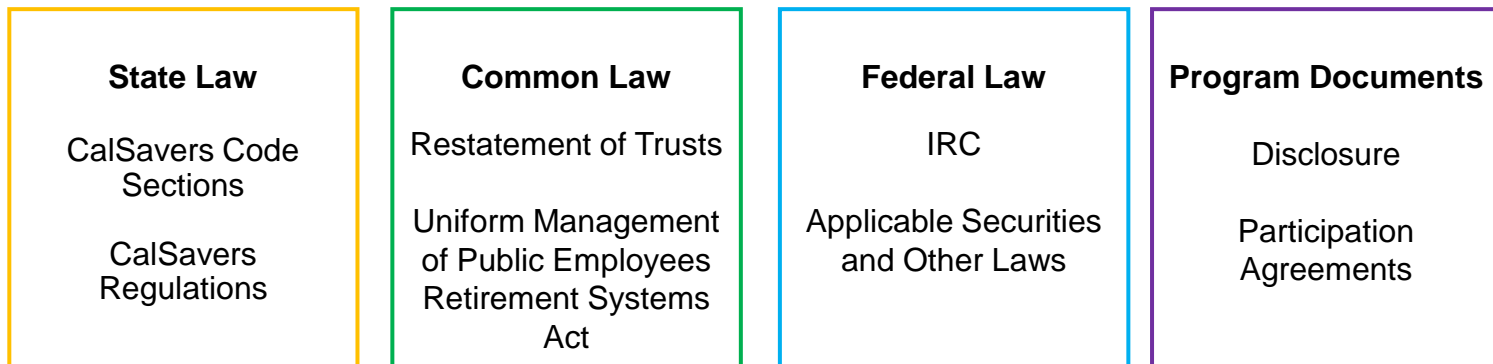
- **Regardless of administration, boards and trustees are fiduciaries**
- **Other parties also may be fiduciaries**
- **Breaches of fiduciary duty have serious consequences**
- **Understanding the duties and implementing thorough decision-making processes mitigate the risk of a fiduciary breach**

Who is a Fiduciary?

- **Boards and trustees** are the highest-level fiduciaries with the broadest responsibility
- **Others** may be fiduciaries, too, by virtue of the work they perform or by contract:
 - Executive Directors
 - Investment managers and municipal advisors
 - Not auditors or attorneys
- **Determined by work performed:**
 - Do they have discretion over program administration or management of the assets
 - Not merely the performance of ministerial tasks

Sources of Fiduciary Duties

- **California Code Sections authorizing and establishing CalSavers are primary sources**
- **Fiduciary law is based on common law of trusts developed over time by case law**
- **Sources for and guidance on fiduciary duties:**



Common Law Underpinnings

- **Duty of Care:**
 - Act in good faith, in the best interest of the entity
 - Standard: ordinarily prudent person acting under similar circumstances
 - Seek professional assistance where necessary
- **Duty of Loyalty:**
 - Put entity's interests ahead of personal interests
 - Act solely for the benefit of participants
- **Duty of Obedience:**
 - Follow governing documents and the entity's mission
 - Comply with the law

The Board's Fiduciary Duties

- The most important duties for CalSavers fiduciaries are those of loyalty, prudence and plan document adherence – CalSavers Code section 100002(d)
- **Duty of Loyalty:**
 - “Exclusive benefit rule”
 - Unwavering commitment to stay focused on the interests of the participants in the Program
- **Duty of Prudence:**
 - Requires expertise and more than a good faith attempt to try to do the right thing
 - *“The Board... shall discharge their duties as fiduciaries...by investing with the care, skill, prudence and diligence...that a prudent person would use...”*
 - Test of prudence is CONDUCT, not RESULTS
- **Duty of Obedience:**
 - Follow the California Code and CalSavers Regulations

Duty of Loyalty

- **Also known as the “Exclusive Benefit Rule”**
 - “The board...shall discharge their duties as fiduciaries with respect to the trust solely in the interest of the program participants...” *CalSavers Code section §100002 (d)*
- **Interpretation of loyalty**
 - When creating policies or making other decisions for the Trust, the fiduciaries can “only wear one hat ”
 - Courts have held that a trustee may not wear a second hat as a representative of an entity that may have appointed him or her to the fiduciary position
 - Trustees are not to balance interests of outside parties
 - Trustees are not to act in their own self-interest

Duty of Loyalty, cont'd

- **Each Board member has a fiduciary duty that is owed to all participants in the trust**
- **There will be those who expect you to represent them and be their advocates when you serve on the Board, but**
 - No fiduciary duty is owed to whoever appointed you
 - No fiduciary duty is owed to the local business community
 - No fiduciary duty is owed to taxpayers of the state
 - No fiduciary duty is owed to employers who facilitate employee contributions to CalSavers
 - No fiduciary duty is owed to the Legislature or Executive Branch
- **Regardless of how one comes to serve on the Board, the fiduciary duty is the same for each participant**

Additional Fiduciary Duties

- **Duty to Diversify:**
 - Flows from prudence
 - Investments should be diversified unless not prudent
- **Duty to Refrain from Prohibited Transactions:**
 - Avoid self-dealing and all conflicts of interest
- **Duty to Delegate:**
 - Prudence allows for delegation but not abdication
 - Boards cannot delegate appropriate monitoring

Federal Guidance on Fiduciaries

- **Employee Retirement Income Security Act of 1974 (“ERISA”)** may provide some fiduciary standards
- **Investment Company Act of 1940 (“40 Act”)** can provide governance standards for unregistered investment options
- **Internal Revenue Code of 1986**, as amended, on non-profits can provide governance considerations
- **Uniform Management of Public Employees Retirement Systems Act (“UMPERSA”)**
- **Uniform Prudent Investor Act (“UPIA”)**

ERISA and Public Funds

- **Generally, ERISA does not apply to governmental plans, i.e. public pension funds**
- **State laws and regulations govern public funds**
- **State fiduciary standards are usually modeled after ERISA**
 - Since ERISA reflects relevant trust law, its “spirit” is usually followed by the courts if there is an absence of stated or written standards
- **Bottom line – guidance provided by ERISA is a good foundation for trustees of public funds**

ERISA on Fiduciaries

- **Status is based on the functions performed, not just a person’s title, held to a “prudent expert standard”:**
 - “With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man **acting in a like capacity and familiar with such matters** would use in the conduct of an enterprise of like character and with like aims...” *
- **Includes the trustee, investment advisers and individuals exercising discretion in administration**
- **Excludes attorneys, accountants and actuaries acting in their professional capacity**

* ERISA 404(a)(1)(B) (*Emphasis added*)

'40 Act on Governance Duties

- **Directors of investment companies and public companies generally share common responsibilities**
- **Examples of duties specific to investment company directors:**
 - Approve time of NAV calculations and procedures for valuation of securities
 - Approve trading practices and procedures
 - Approve investment objectives and policies
 - Monitor credit quality and valuation of funds

Statutory Foundation

- **The CalSavers Act establishes the Board as the creator of a municipal trust:**
 - CalSavers participants open IRA accounts
 - Contributions to the IRA accounts are invested in units of the trust, which are “securities”
- **Securities Act of 1933:**
 - Municipal securities are exempt from registration
 - *Anti-fraud provisions apply to issuers*
- **Securities Exchange Act of 1934:**
 - Municipal securities are exempt from most reporting requirements
 - *Municipal securities are subject to anti-fraud provisions*
- **Trust Indenture Act of 1939:**
 - Provisions do not apply to municipal securities

Statutory Foundation, cont'd

- **Investment Company Act of 1940 and Investment Advisers Act of 1940:**
 - Provisions do not apply to instrumentalities of a State or agents “acting in the course of official duty”
- **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010:**
 - Advisers to municipal entities are subject to varying degrees of oversight by FINRA, the MSRB and applicable Bank Regulators

Importance of the '33 and '34 Acts Together

- **Municipal trusts do not register securities or sales of securities**
- **BUT anti-fraud provisions of both Acts *always* apply:**
 - Section 17(a) – Fraudulent Interstate Transactions ('33 Act)
 - Section 10(b) – Manipulative and Deceptive Devices ('34 Act)
 - Rule 10b-5 – Employment of Manipulative and Deceptive Devices ('34 Act)
- **Content is always subject to anti-fraud prohibitions of securities laws:**
 - “It is unlawful to make *any untrue statement of a **material** fact or to omit to state a **material** fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading*”
 - *Interpretation:* You cannot lie about a **material** fact and you can't fail to state a **material** fact IF that **material** fact would make the statement not misleading ... In other words, if that **material** fact would have caused the investor not to be misled...or maybe not to have invested

Fiduciary Liability

- **Laws governing fiduciaries may impose liability for breach of duty:**
 - Sovereign immunity may apply
- **Delegating responsibility may shift the liability BUT:**
 - Oversight is still required
 - Delegation must continue to be prudent
- **Consequences of breach of duty:**
 - Personal liability for losses and restoration of profits that have been made through use of Program assets
 - Other equitable or remedial relief as a court may deem appropriate
 - Liability usually not relieved in bankruptcy
- **Attorney-client privilege may run to the Program rather than to an individual fiduciary**

Co-Fiduciary Liability

- **“You are your brother’s and sister’s keeper” ... “you have a duty to squeal”**
- **Liability can result if a fiduciary enables, knowingly participates in, or knowingly undertakes to conceal a breach by another fiduciary**
- **A fiduciary has a duty to speak up and take reasonable steps to prevent or halt a co-fiduciary’s breach**
- **Resignation from the Board is usually not sufficient**

Mitigating Fiduciary Liability

- **Have a clear understanding of fiduciary duty and where it exists**
- **Establish disciplined and thorough decision-making processes**
- **Obtain expert advice as appropriate**
- **Be prudent in delegations and diligent in oversight**
- **Initial orientation and continuing education on fiduciary responsibility**

Summary of Board Member's Responsibilities

- Act in the interest of CalSavers' participants
- Understand the subject matter (seek expert advice if necessary)
- Carry out duties prudently
- Follow CalSavers' documents
- Diversify Program investments
- Pay only reasonable expenses
- Delegate but do not abdicate fiduciary duties

Section 2.

Guidance on Good Governance

What is Governance?

- **The structure, manner, and process by which a Board exercises authority or control**
- **Good governance begins with understanding of fiduciary duty**
- **Good governance policies and practices can help Boards meet fiduciary responsibilities**
- **Governance is not:**
 - Management
 - Day-to-day operations
 - Tactical decisions
 - Staff functions
 - Details of policy implementation

Essential Elements of Good Governance

- **Accountability**
- **Transparency**
- **Adherence to laws, rules and policies**
- **Inclusiveness – engaging in participatory processes**
- **Clear distinction between roles of the Board and the staff**

Exhibiting Good Governance

- **Procurement Processes**
- **Investment Policy Statements**
- **Performance Benchmarks (Administrative and Marketing)**
- **On-going Program and Investment Reviews**

Processes for Governance

- **Procurement Processes:**
 - Delineate appropriate roles for Board and staff in –
 - Development and approval of RFPs
 - Evaluation of responses
 - Final approval of contracts
 - Staff should ensure open and fair solicitations
 - Recommendations should reflect weighted criteria that bidders understand
 - If sole source procurement, basis for closed process should be clear
- **Investment Policy Statements and Monitoring Criteria:**
 - Establish roles, responsibilities and process
 - Also defines selection criteria and monitoring procedures
 - Ramifications for underperformance should be clear
- **Establishment of Performance Benchmarks:**
 - Administration and operations
 - Marketing costs and results
 - Investment policies and performance targets

Processes for Governance, cont'd

- **On-going Reviews:**
 - Monthly investment results to key staff and independent Investment Consultant from Investment Manager
 - Quarterly reports to the Board from Program Manager (including the Investment Manager) and the independent Investment Consultant
 - Quarterly reports to the Board from the Program Manager on agreed upon administrative and marketing benchmarks

Governance Best Practices

- **Prepare for and attend all meetings**
- **Act in good faith and in the best interest of all participants**
- **Know and abide by applicable laws, regulations and Program policies**
- **Where appropriate, delegate to experts but maintain vigilant oversight**
- **Establish and document prudent processes; review regularly to ensure consistency and relevancy**

The Bottom Line

- **Prudence is more than just trying to do the right thing:**
 - Understand what's being voted on
 - Investigate all options
 - Seek expert advice
- **A good process is more important than a good outcome:**
 - Written procedures are critical
 - Following established procedures and written policies is the best defense to liability
- **Fiduciary duties require prudence, not necessarily perfection!**

Appendix 1

Checklist – Common and Best Practices

Checklist – Common and Best Practices

- **Prepare for and attend all meetings**
- **Act in good faith and in the best interest of participants in all decision making**
- **Be familiar with and abide by all applicable laws, regulations and Program documents**
- **Delegate, where appropriate, to experts pursuant to a prudent process**
- **Establish and document prudent processes**
- **Periodically review policies and procedures to ensure consistency and relevancy**
- **Differentiate Board policies from management policies**
- **Take actions consistent with the mission and policies of the Program**

Checklist – Common and Best Practices, cont'd

- **Perform continual oversight – applies to Board and staff**
- **Institute reporting tools and procedures that facilitate oversight**
 - Internal Sources examples –
 - Executive Director Reports
 - Internal Audit
 - Risk Management Dashboard
 - External Sources examples –
 - Program Administrator
 - Investment Manager(s)
 - Investment and Program Consultants
 - Independent Auditors
- **Clearly define and enumerate roles and responsibilities between the Board and staff**
- **Regular review of efficiency and effectiveness of the Program's goals**

Checklist – Common and Best Practices, cont'd

- **Assess performance and actions of staff and service providers**
- **Benchmark operations to similar programs and best practices**
- **Obtain independent expert advice**
- **Require transparency and accountability**
- **Communicate with all stakeholders in a timely, accurate and transparent manner**
- **Maintain confidentiality of participant information**
- **Offer orientation and continuing education on relevant topics**

Appendix 2

Statutory and Regulatory Sources

Employee Retirement Income Security Act of 1974 (“ERISA”)

- **Federal law that establishes minimum standards for pension plans in private industry regarding participation, vesting, benefit accrual and funding**
- **ERISA plans must provide participants with information about plan features and funding, and furnish information regularly and free of charge**
- **Provides extensive rules on the federal income tax effects of transactions associated with employee benefit plans**
- **ERISA requires accountability of plan fiduciaries, and, in addition to insuring participants are informed, it also gives participants the right to sue for benefits and breaches of fiduciary duty**
- **[COMPS-896.pdf \(govinfo.gov\)](#)**

Uniform Management of Public Employee Retirement Systems Act (“UMPERSA”)

- Provides rules that permit public employee retirement systems to invest in the most productive and secure manner by declaring that all retirement system assets are held in trust, except for certain insurance-based assets
- Assures that public employees are guaranteed the highest standard of conduct in the management and investment of retirement assets that the law can establish
- Empowers Trustees to establish an administrative budget and to employ the services necessary to administer the trust
 - May delegate functions that "a prudent trustee or administrator acting in like capacity and familiar with those matters could properly delegate under the circumstances."
- Follows the Uniform Prudent Investor Act
- [Management of Public Employee Retirement Systems Act - Uniform Law Commission \(uniformlaws.org\)](#)

Uniform Prudent Investor Act (“UPIA”)

- Reflects changes in investment practice since the late 1960s, specifically with regard to modern portfolio theory
- Establishes that standard of prudence applies to any investment in the context of the total portfolio, rather than to individual investments
- Allows trustees to delegate investment management functions, subject to appropriate safeguards (such delegation was expressly forbidden by the former trust law)
- Fosters a greater degree of diversification in investment portfolios and allows for derivatives, commodities and futures:
 - Despite these investments individually having a relatively higher degree of risk, they could potentially reduce overall portfolio risk and boost returns when considered in a total portfolio context.
- [Prudent Investor Act - Uniform Law Commission \(uniformlaws.org\)](http://uniformlaws.org)

Securities Act of 1933 (the “33 Act”)

- Exempts issuers of municipal securities from registration (Section 3(a)(2))
- “Truth in securities” has two basic objectives:
 - Requires that investors receive financial and other significant information about securities being offered
 - Prohibits deceit and misrepresentation in the sale of securities
- [COMPS-1884.pdf \(govinfo.gov\)](#)

Securities Exchange Act of 1934 (the “34 Act”)

- Created the SEC and empowers it to register, regulate and oversee:
 - Brokerage firms, clearing agencies and transfer agents
 - Self regulatory organizations (“SROs”) including Financial Industry Regulatory Authority (“FINRA”) and the Municipal Securities Rulemaking Board (“MSRB”)
- Establishes periodic reporting requirements for registered entities or transactions
 - Municipal securities generally are exempt from reporting requirements (Section 3(a)(29))
 - BUT some initial and ongoing disclosures apply (Rule 15c2-12)
- Identifies and prohibits deceitful conduct
- Grants the SEC disciplinary powers over regulated entities and the persons associated with them
 - SROs are essential to the entire process (municipal broker-dealers may not contravene any rules of the MSRB (Section 15B))
- [COMPS-1885.pdf \(govinfo.gov\)](#)

Trust Indenture Act of 1939

- **Applies to debt securities – including bonds and interests in publically offered trusts**
- **Requires a trustee to protect and enforce the rights of bondholders and rights must be included in a trust indenture**
- **Municipal trusts are exempt based upon '33 Act exemption (Section 304(a)(4)(A))**
- **[COMPS-1888.pdf \(govinfo.gov\)](#)**

Investment Company Act of 1940 (the “40 Act”)

- **Regulates companies that engage primarily in investing, reinvesting and trading in securities**
- **Focus of the Act is to provide the public with information about a fund and its objectives, and about the investment company structure and operations**
- **Explicitly not applicable to government entities or officers or employees “acting as such in the course of his official duty” (Section 2(b))**
- **[COMPS-1879.pdf \(govinfo.gov\)](#)**

Investment Advisers Act of 1940 (the “Advisers Act”)

- Firms that provide advice about securities investments must conform to regulations designed to protect investors:
 - Advisers with more than \$100 million in client assets must file Form ADV with SEC
 - If assets > \$25 million but < \$100 million, adviser registers with state
- Does not apply to states or subdivisions or to officers or employees “acting as such in the course of his official duty” (Section 202(b))
- [COMPS-1878.pdf \(govinfo.gov\)](#)

Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

- Amends Section 15B ('34 Act) to require registration of municipal advisors and imposes fiduciary duty on them
- "Municipal advisor" is any person that provides advice to or on behalf of a municipal entity regarding municipal securities, including advice with respect to the structure, timing, terms and similar matters concerning such issues
- Excludes registered Investment Advisers, attorneys offering "legal advice", engineers and accountants
- Act also creates the Consumer Financial Protection Bureau
- [COMPS-9515.pdf \(govinfo.gov\)](#)

Municipal Securities Rulemaking Board (“MSRB”)

- **Established by Congress in 1975:**
 - Mission is to protect investors, municipal entities and obligated persons, and to promote a fair and efficient municipal market
 - Operates Electronic Municipal Market Access (“EMMA”) to promote **transparency and provide widespread access to information**
- **MSRB rules are intended to:**
 - Prevent fraudulent or manipulative practices
 - Promote just and equitable principles of trade
- **Has no enforcement powers – its rules are enforced by:**
 - FINRA for securities firms
 - Office of the Comptroller of the Currency, the Federal Reserve, or the FDIC for banks
 - SEC for municipal advisors, securities firms and bank dealers
- **Bottom line: jurisdiction is over securities firms, municipal dealers and municipal advisors, NOT municipal issuers**
- msrb.org

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