



# CalPERS

## Board of Administration Fiduciary Training

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ARTICLE XVII  
**Public Finance**  
[SECTION 1 - SEC. 10]  
(Article 18 heading omitted from 1979)

**SEC. 17.**

The State shall not in any manner to, or be interested in the stock of corporation, except that the State and hold shares of the capital of corporation when the stock is used for furnishing a supply of water for purposes; and the holding of the all of the rights, powers and the obligations and liabilities of holders of stock in the mutual the stock is so held.

Notwithstanding any other to the contrary, the retirement system shall have plenary authority over the management of moneys and assets.

# Who is a Fiduciary?

## Who is a fiduciary?

- Definition from Merriam-Webster: “Fiduciary relationships often concern money, but the word *fiduciary* does not, in and of itself, suggest financial matters. Rather, *fiduciary* applies to any situation in which one person justifiably places confidence and trust in someone else and seeks that person's help or advice in some matter.”
- Derived from the Latin word “fidere” which means “to trust.”
- Distinguish from “settlor.”

# CalPERS' Fiduciary Statements

What does CalPERS say?

- “Our mission is to deliver retirement and health care benefits to members and their beneficiaries.”
- “As fiduciaries, our duty is to our members and their beneficiaries.”
- “All investments have risks. We have a fiduciary duty to minimize risk in our portfolio and take advantage of opportunities on behalf of our 1.9 million members.”

# Evolution of Fiduciary Laws

	ERISA	Trust Law	California Constitution
Source	Federal statute enacted in 1974; modeled on trust law	Common law; term first used in 1631; Restatement of Trusts; constantly evolving	Enacted by Proposition 162 in 1992
Applicable to Governmental Plans	No, but robust regulatory framework and guidance are helpful guideposts	Yes	Yes
<b>Core Fiduciary Duties</b>	<b>Loyalty Prudence/Care Diversification Plan document</b>	<b>Loyalty Prudence/Care Diversification Plan document</b>	<b>Loyalty Prudence/Care Diversification Plan document</b>

# Comparison of Fiduciary Laws Governing Core Duties

## – Loyalty –

ERISA	Restatement of Trusts	California Constitution
“A fiduciary shall discharge his duties ...”	“The trustee has a duty to ...”	“[The board] shall discharge their duties ...”
“... solely in the interest of the participants and beneficiaries and for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan.”	“... administer the trust solely in the interest of the beneficiary.”	“... solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.”

# Comparison of Fiduciary Laws Governing Core Duties

– Prudence / Care –

ERISA	Restatement of Trusts	California Constitution
<p>“A fiduciary shall discharge his duties ...”</p> <p>“... 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 a like character and with like aims”</p>	<p>“The trustee has a duty to ...”</p> <p>“... the trust as a prudent person would ... [with] reasonable care, skill, and caution. If the trustee possesses ... special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use such facilities or skill.”</p>	<p>“[The board] shall discharge their duties ...”</p> <p>“... with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.”</p>

# Comparison of Fiduciary Laws Governing Core Duties

– Plan Document –

ERISA	Restatement of Trusts	California Constitution
“A fiduciary shall discharge his duties in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with [ERISA].”	“The trustee has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law.”	Not specified, but part of duty of prudence.

# Comparison of Fiduciary Laws Governing Core Duties

## – Diversification –

ERISA	Restatement of Trusts	California Constitution
“A fiduciary shall discharge his duties by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.”	“[The] trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.”	“[The Board] shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.”



# Key Enumerated Duties Specific to CA Constitution

## Assure competency of retirement system assets

“The retirement board of a retirement system... consistent with the exclusive fiduciary responsibilities vested in it, shall have the *sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the...retirement system.*”

—Cal. Const., art. XVI, § 17(e) (Emphasis Added)

## Prompt delivery of benefits and related services

“The retirement board of a ... retirement system shall have the sole and exclusive fiduciary responsibility...to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries....”

—Cal. Const., art. XVI, § 17(a)

# Other Fiduciary Obligations Stemming from Core Duties

- **Duty to Communicate Material Information**
- **Duty to Maintain and Secure Confidential Information**
- **Duty to Maintain Tax-Qualified System**

# Fiduciary Obligations are Dynamic

## Evolution of Duty of Prudence as to Investment

### Practices

"There are no universally accepted and enduring theories of financial markets or prescriptions for investment that can provide clear and specific guidance to trustees and courts. Trust investment law should reflect and accommodate current knowledge and concepts. It should avoid repeating the mistake of freezing its rules against future learning and developments."

Restatement (Third) of Trusts § 227, comment (f)

# Fiduciary Duty of Care/Prudence: Divestment Mandate?

## Statutorily-provided divestment

“The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and *provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.*”

Cal. Const., art. XVI, § 17(g) (Emphasis Added)

# Fiduciary Duty of Care: Divestment Mandate?

## CalPERS' Statements

“The call for divestment has become an increasingly popular tool for promoting an important cause or belief. As laudable as the underlying motivations may be, divestment has unintended consequences for the CalPERS fund, our Board and our members. The most acute is a conflict for the CalPERS Board of Administration (Board), which has a fiduciary duty to its members.”

“As a government agency, CalPERS is sensitive to public policy issues, but divestment pits social responsibility against our fiduciary obligations. Why? It Increases Risk. . . . We Lose our Voice [‘seat at the table’] . . . We Lose Money.”

“While our primary stakeholders are the more than 1.8 million members [as of 2017], the more than 3,000 employers, and the millions of California taxpayers who collectively bear the economic consequences of CalPERS’ investment decisions, CalPERS has many stakeholders who express opinions on investment strategy or ask CalPERS to engage on a particular issue. We must weigh the costs, risks, and unintended consequences of divestment against our fiduciary duty to California’s public employees.”

CalPERS and Divestment Rev. 3/30/17

# Types of ESG Policies – Divestment and Investment

- E** **Environmental**  
Climate change, waste, pollution, resource depletion, deforestation
- S** **Social**  
Employee relations and diversity, working conditions, human rights
- G** **Governance**  
Leadership, board diversity and structure, executive pay, shareholder rights, proxy voting, transparency, accountability

# Types of ESG Policies – Divestment and Investment

## Divestment from:

- **Certain Other Countries (Turkey)**
- **Fossil fuels**
- **Tobacco**
- **Weapons**

## Investment in:

- **Clean technology**
- **Renewable energy**
- **Emerging Managers**

# Evolving DOL Guidance on ESG Factors

(Not applicable to governmental plans, but informative)

## 1994 Interpretive Bulletin

A fiduciary may consider a collateral benefit (such as an ESG) as a deciding factor in a tie-breaker scenario, but only if:

- The fiduciary determines that the investment option with the collateral benefit is expected to provide fundamentally the same investment return as available alternative investment options with similar risk characteristics, and
- The investment is otherwise appropriate for the plan in terms of diversification.

## 2008 Interpretive Bulletin

The use of non-economic factors in selecting investments should be rare.



# Evolving DOL Guidance on ESG Factors

(Not applicable to governmental plans, but informative)

## 2015 Interpretive Bulletin

Reinstated the 1994 position. Added that ESG factors may be valid financial factors to consider even without a tie-breaker situation.

- If a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from ESG factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote (no need to apply “tie-breaker” rules).
- ESG factors can be used as tie-breakers - fiduciaries may invest based, in part, on collateral benefits, so long as the investment is economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits.

# Evolving DOL Guidance on ESG Factors

(Not applicable to governmental plans, but informative)

## 2020 Interim and Final Regulations

Plan fiduciary's evaluation of plan investments must be focused solely on economic considerations that have a material effect on the risk and return of an investment based on appropriate investment horizons, consistent with the plan's funding policy and investment policy objectives. The corollary is that fiduciaries must not sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals (“non-pecuniary” vs. “ESG” terminology).

- Rare (and burdensome) tie-breaker: If unable to distinguish investments on the basis of pecuniary factors alone, the fiduciary may use non-pecuniary factors as the deciding factor in the investment decision provided the fiduciary documents: (i) Why pecuniary factors were not sufficient to select the investment or investment course of action; (ii) How the selected investment compares to the alternative investments with regard to the factors listed above that apply when evaluating investments; and (iii) How the chosen non-pecuniary factor or factors are consistent with the interests of participants and beneficiaries in their retirement income or financial benefits under the plan.

# Evolving DOL Guidance on ESG Factors

(Not applicable to governmental plans, but informative)

## Non-Enforcement Policy and Biden Executive Order

- **March 2021**  
DOL issued a non-enforcement policy stating it would not enforce the 2020 final regulation or pursue actions against a fiduciary for failure to comply.
- **May 2021**  
President Biden’s executive order on climate-related financial risk asked the Secretary of Labor to “consider publishing, by September 2021 ... a proposed rule to suspend, revise, or rescind” the 2020 final regulation.

# ESG Fiduciary Considerations

- ESG initiatives have varied by Presidential administration/party affiliation.
- The duties of loyalty and care/prudence remain the drivers in evaluating ESG considerations.
- ESG factors linked to proxy voting, as it impacts non-pecuniary factors.

# Fiduciary Duty of Loyalty: Collateral Interests?

## Collateral interests of Board members?

The strict duty of loyalty in trust law ordinarily prohibits the trustee from...investing in a manner that is intended to serve interests other than those of the beneficiaries or the purposes of the settlor. *Thus, for example, in managing the investments of a trust, the trustee's decisions ordinarily must not be motivated by a purpose of advancing or expressing the trustee's personal views concerning social or political issues or causes.*

Rest. 3d Trusts, supra, § 227, p. 12, comment c (Emphasis Added)

# Fiduciary Duty of Care: Delegation

“A trustee has a duty personally to perform the responsibilities of the trusteeship except as a *prudent person might delegate those responsibilities* to others. In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a *prudent person* would in act in similar circumstances.”

– Rest. 3d Trusts, supra (Prudent Investor Rule, § 171, adopted in 1992) (Emphasis Added)

Uniform Prudent Investors Act:

- A trustee may delegate investment and management function that a prudent trustee of comparable skills could properly delegate under the circumstances . . .” 7B Unif. Laws Ann. (2000) at 303.

# Fiduciary Duty of Care: Delegation

On delegation, a California court ruling on the *Tibble* series of cases:

- “In order to determine whether an investment decision is prudent, a fiduciary has a duty to investigate, and may secure independent advice from financial advisors or other experts in the course of the investigation. *Donovan v. Bierwith*, 680 F.2d 263, 272-73 (2d. Cir. 1982). **However, the fact that a fiduciary secured independent advice does not necessarily indicate that he acted prudently.** *Howard*, 100 F.2d at 1489; *Bierwith*, 680 F.2d at 272; *George v. Kraft Foods Global, Inc.*, 641 F.3d 786, 799 (7th Cir. 2011) (reversing grant of summary judgment for defendants on breach of prudence claim because “relying on the advice of consultants” is not a complete defense).”

U.S.D.C., Central District of California Court of Appeal, Findings of Fact and Conclusions of Law, CV 07-5359 SVW (AGRx) (2018) (Emphasis Added)

# Fiduciary Duty of Care: Prudent Delegation

The Board of Administration has adopted a Governance Policy that articulates:

- The legal authority under which the Board operates
- Governance principles to which the Board collectively has committed
- Responsibilities of individual Board members and of the Board
- Roles of the Board President, Vice-President, Chairs and Vice-Chairs
- Delegations to CalPERS executives and Board reporting relationships



# Fiduciary Duty of Care: Prudent Delegation

Board members' compliance with their individual fiduciary duty as trustees includes acting within the parameters of the Board's Governance Policy.

Board members should remain familiar with the Governance Policy and note that the Policy includes provisions by which the Board as a whole, and the Board President, governs Board members' compliance with the Policy through potential public or private discipline.

(Governance Policy, Section V, B (2) and Section VIII, B(2), respectively.)

# Fiduciary Duty of Care: Consultation with Experts

“To the extent necessary or appropriate to the making of informed investment judgments by the particular trustee, care also involves securing and considering the advice of others [such as legal, actuarial and investment counsel] on a reasonable basis.”

– Rest. 3d Trusts, supra, § 227, p. 15, comment d.

The implicit corollary to the duty to consult with experts is that if a fiduciary fails to follow the advice of its professional consultants, it must demonstrate an informed, reasonable, and prudent rationale for failing to do so.

Another implicit corollary is that expert advice from a reasonable source should provide the basis for a Board’s decision to take an alternative course of action on a topic within that area of expertise (e.g., investment, actuarial, legal).

# Fiduciary Duty of Care: Delegation

**Prudence** is the key to all aspects of delegation:

- Whether (and how much) to delegate
- How to delegate
- To whom to delegate
- Monitoring delegate(s)
- Discontinuance of delegation

# Fiduciary Training: Key Takeaways

## **Duties of Care/Prudence and Loyalty are essential in performing all fiduciary functions:**

- Apply the mission statement: “Our mission is to deliver retirement and health care benefits to members and their beneficiaries.”
- Consider the stakeholders
- Actively participate in meetings
- Implement governance policies:
  - Maintain familiarity with governance policies
  - Review and, as necessary revise governance policies
  - Be consistent in applying policies unless and until they are altered
- Keep informed of changing industry practices and market trends
- Delegate and monitor experts