

CITY OF FORT PIERCE - OFFICE OF THE CITY ATTORNEY

MEMORANDUM

TO: Thomas K. Perona, Chair, Fort Pierce Retirement System

FROM: James T. Walker, Assistant City Attorney

RE: Report on 2014 NAPPA Conference

DATE: July 21, 2014

A famous author, Louis L'Amour, once said "Knowledge is like money: to be of value it must circulate and in circulating it can increase in quantity and, hopefully, in value". In that spirit there is undertaken here a report to the Fort Pierce Retirement Board on this year's educational conference of the National Association of Public Pension Attorneys. The Board's authorization of such attendance is and was appreciated and my intent is to express thanks by passing along some of the information and knowledge acquired. In so doing, I offer two caveats: first, the conference is almost a week long and covers a massive amount of material. There are well over 500 pages in outline material and it is simply not possible to offer a comprehensive overview of that record in this memo. Not even theoretically – many of the breakout sessions were scheduled concurrently so I was obliged to be selective in limiting my attendance to those deemed of most interest. Nevertheless, for the benefit of the inquisitive, with this memo there is also a disc or memory stick which does contain the entire record of the conference.

Second, it must be admitted that much of the material is quite sophisticated and covers complex issues beyond the scope of what is typically encountered in our own comparatively little system where other conference attendees were there representing systems worth many billions of dollars, with dozens of full-time staff employees. I do not pretend that everything presented was grasped or even understood. But in any case I aspired in those instances to at least attain Plato's second level of knowledge: if we don't know, at least we learn that we do not know and can therefore spot the issue and go looking for an answer if encountering the issue subsequently.

The conference opened with a "New Member and Associate Counsel Session: The Basics", devoted to a review of basic principles. That same session opens the conference each year and is a useful reminder of the fundamentals. Moreover, something new is learned there each time. Our Board members should be familiar with the material there,

if they are not already. Those materials are therefore attached here in their entirety (see # 1). The structure and governance of municipal plans, such as this City's, are subject to their plan documents (see ex. this Board's investment policy, and Ch. 13 of the Code of Ordinances), the contract clause of the United States Constitution (no state shall pass any ... law impairing the obligations of contracts"), the Internal Revenue Code and ERISA. ERISA is the Employee Retirement Income Security Act of 1974. Other important federal legislation affecting governmental plans includes ADEA (Age Discrimination and Employment Act), ADA (Americans with Disabilities Act), USERRA (Uniformed Services Employment and Reemployment Rights Act), the Civil Rights Act and FMLA (Family and Medical Leave Act). It is important to realize that ERISA, which applies across the board to all private pension funds, mostly exempts governmental plans from its provisions. Defined Benefit Plans ("DB Plan") are compared and contrasted with defined contribution plans ("DC Plan"), with a summary of their respective advantages and disadvantages, while also discussing hybrid plans (see Pgs. 2, 3). As an entity enjoying favorable tax treatment as conferred by Section 401 of the Internal Revenue Code, the governmental plan is required to rest upon a "plan document" which contains required provisions relating to membership, service credit, salary, vesting, normal retirement and retirement benefit options (see Pgs. 3-6). All such topics are covered by Chapter 13 of the Fort Pierce Code of Ordinances and Board members should be generally familiar with them. This Board encounters QDRO's from time to time and these are discussed generally in the outlines (see ex. Pgs. 7-8). QDRO's are covered by this Board's Rule 16 and applicable court decisions – they are an exception to the rule that retirement benefits are exempt from claims of creditors and third parties. Board members are under a fiduciary duty to protect the system's qualified tax status and to see that it provides for the best tax treatment for members benefits. There is an interesting outline by Ms. Terry Mumford which summarizes what that entails as she discusses the importance of plan qualification, what that means in terms of specific tax provisions, and the "determination process" which serves as a vehicle for verifying plan compliance; our own plan was requalified several years ago by the IRS in 2011 and it may be appropriate to consider a resubmittal in either the next following approval cycle in 2015 or immediately thereafter. IRS regulates governmental plans closely and a fine summary of plan requirements is set out in Ms. Mumford's outline dealing with mandatory/optional membership, vesting, contribution limits, benefit limitations and payments, rollovers, trusts and taxation (see Pgs. 7-14). For my own purposes, there is particularly useful a summary of code provisions specifically applicable to governmental plans (see attachment A). Fiduciary obligations imposed on Board members are summarized in an outline by Bill Akerman, in the form of PowerPoint charts. Here he discusses the duty of loyalty and the duty of care imposed on trustees requiring that they act solely in the best interests of the members, retirees and beneficiaries of the system, that they avoid conflicts of interest and self-dealing, and discharge their duties with care, skill and prudence, incurring only expenses that are appropriate and reasonable, while conforming with requirements of

applicable law. Fiduciary responsibility may be broadly broken out in four (4) categories: Fund Management and Administration; Communications and Education; Investment-Related Activity and Selection of Consultants/Advisors. Should it be necessary for this Board to hereafter consider retaining new or replacement investment managers/consultants, it will be useful to consult the suggested steps and procedures set out in the materials (see Pgs. 7-10).

I attended a series of breakout sessions, the first of which was titled “Small and Medium Fund Affinity Group”. Here there was a panel led by a moderator which encouraged audience discussion of several topics of interest. One of these was how to go about addressing overpayments. That is a problem, fortunately, which this Board has not been forced to come to terms with heretofore. But it can be a tricky, complicated problem when it does arise. Efforts to recoup overpayments will often meet up with pleas of hardship and demands for waiver. State courts are often sympathetic with the equitable position of retirees and a board can be trapped between state court rulings and contrary fiduciary obligations imposed by IRS requirements which limit board flexibility in forgiving the obligation of repayment. Retirement boards can sometimes be mired in public controversy and there was a discussion about dealing with “bad press” and individual board members who may sometimes offer opinions or statements to the press at odds with their fiduciary responsibility to the system. The consensus view among attendees was that if high visibility controversies arise, only one person should be authorized as “spokesman” to speak for the board when the press comes looking for comments. Adoption of a formal policy on the subject was recommended and this is a topic that our own Board might conceivably wish to consider regulating with a formal rule. Some plans have adopted sophisticated websites allowing member interaction or access to member accounts. Such computer portals present issues and those came under discussion, including verification of identity (consider a PIN), and access by third parties, such as an ex-spouse. There was extensive discussion about what a board should do when its sponsor fails to fully fund its obligations for one reason or another. Conceivably, depending upon the circumstances, the board might be under an obligation to actually sue its sponsor to assure that the system is properly funded. Fortunately, here in Florida municipal sponsors do not presently enjoy much flexibility in that regard so the issue is not as acute for us as it is elsewhere.

Of interest was a “corporate governance” breakout (see # 3). A recent development which may or may not prove to be very important in the future is the Treasury Department’s creation of an Office of State and Local Finance. That is apparently being created as a vehicle for further IRS involvement in pension regulation but it is too soon to determine the impact there. Under Dodd Frank there is a newly created Financial Services Oversight Counsel (FSOC) which may eventually – though not presently – target pension funds in the same manner as it is currently scrutinizing Asset Management

Funds. But in truth, not much is happening with implementation of Dodd Frank and only 50% of the rulemaking deadlines required by that Act have been met. This includes SEC activity as regulators face a difficult environment as they deal with pressure from Capitol Hill and numerous legal challenges. A “hot issue” right now for pension funds involves their status as activists in seeking oversight of corporations in which they are invested. Specific issues involve CEO pay, proxy fights, independence of directors and capital allocation. It should be noted that several issues of past concern in previous years, such as regulation by Dodd Frank of certain municipal retirement board members as “advisors” have not moved forward this year any closer to final regulatory status.

Another breakout attended was titled “Tax Update – The Ins and Outs of 1099-Rs (see # 4). This session focused on a plan’s tax reporting responsibilities when making benefit payments to its retirees. This reporting is done through the filing of an IRS Form 1099-R. Although the forms are often filled out through the use of a computer program or by contractors, the fund retains oversight on the adequacy of these filings and must exercise great care about their accuracy. Mistakes can be penalized by IRS at a rate of \$100.00 per return and, particularly in the case of large systems making payments to tens of thousands of retirees, the liability can be enormous. In the event the IRS determines that the mistake was willful, the penalty then becomes the greater of either \$250.00 per return or 10% of the total amount not reported or reported incorrectly. It may behoove the Board to interest itself in this topic to the extent of gaining assurances that the subject is being attended to with diligence.

Perhaps the only area of disappointment in an otherwise strong conference involved the subject of alternative investments. This is a topic of great interest to pension funds generally as they seek security combined with high investment rates, at a time of market volatility combined with record low interest rates. Our own Fund recently entered the field in an effort to maximize return. I therefore wanted as much exposure to the subject as possible, hoping to gain further insight on interpretation and negotiation of terms with prospective alternative investment managers, things to do or not to, and specific language to avoid or to insist upon when entering into management agreements on this sort of investment. Instead, attendees were spoon-fed little more than glib generalizations by the presenters. The presenters were there on behalf of vendors who service institutional clients in this situation. I rather thought that the presenters were more intent on inducing audience members to hire them, the presenters, rather than educating attendees on how to handle things on their own. It was an interesting marketing exercise for the presenters’ firms, but hardly a stellar success in terms of educational value to attendees. I suppose the message is that if we want to get more involved in alternative investments, we should be simply signing them up while, for their purposes, the less we know the better.

Another interesting breakout was entitled “Life in the Post-DOMA/Windsor World” (see # 6). It will be recalled that in *United States v. Windsor*, 570 US 12 (2013) (Docket No. 12-307), the Supreme Court held that Section 3 of the Defense of Marriage Act (“DOMA”), which limited the definition of “spouse” or “marriage” to a person of the opposite sex, is unconstitutional. Initially it was felt that this would be of little impact to plans in states which, like Florida, do not permit same-sex marriage. *Windsor* upheld Section 2 of DOMA which permits states to refuse to recognize the validity of same-sex marriages which are legally performed in other states. But it turns out that, for retirement and Federal tax purposes, the validity of a marriage is determined according to where the marriage was established, rather than where the parties are currently domiciled. Hence, in the event there are any members in the City’s plan who are parties to a same-sex marriage which was entered into in a state where that is permissible, such marriage is to be recognized as valid for purposes of our retirement plan. The critical ruling here is Revenue Ruling 2013-17 (see 6A). This ruling establishes that the terms “spouse”, “marriage”, “husband” and “wife” will include spouses of the same sex, if the couple is legally married under state or federal law. It establishes that the definition of “spouse” is controlled by the place where the marriage took place, not where the parties currently reside. The ruling also determined that “marriage” does not include domestic partnerships or civil unions. The effective date of this ruling is September 16, 2013. Formal regulations are to be issued sometime hereafter regarding plan amendments so as to conform them to the ruling. But a perusal of our Chapter 13 suggests that it is already written in gender-neutral terms so need for amendment is not presently anticipated.

The concluding seminar presentation was a review of retirement-related litigation for the past year (see # 7). None of the cases discussed or included within the outline are Florida decisions. Hence, any case discussed there is of only limited applicability to our own plan. That is, Florida courts will sometimes look to cases in foreign jurisdiction if there is no Florida law governing an issue and the Florida court thinks it would be helpful to see how other states are handling an otherwise novel situation. These cases are illuminating, however, since they demonstrate the vast range of issues that can arise.

s/ James T. Walker

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/mlp

Attachment

cc: Robert V. Schwerer, City Attorney

NATIONAL ASSOCIATION OF PUBLIC PENSION ATTORNEYS
2014 LEGAL EDUCATION CONFERENCE
NEW MEMBER AND ASSOCIATE COUNSEL SESSION

BENEFITS BASICS
FOR GOVERNMENTAL DEFINED BENEFIT PLANS
JUNE 24, 2014

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Virginia Retirement System

I. LAWS GOVERNING OR IMPACTING GOVERNMENTAL PLAN BENEFITS

- A. **“Plan Document”** - State statutes (or local ordinances) establishing the defined benefit plan are generally considered to be the “Plan document.” Regulations or administrative materials may amplify and assist in interpretation of the Plan. In some jurisdictions, legislation authorizes the board to adopt the plan language. The plan document generally covers the benefits offered by the Plan, how the Plan is funded, how the Plan is governed, and how the assets are managed.
- B. **Contract Clause** – Article I § 10 clause 1 of the United States Constitution states “No State shall pass any . . . Law impairing the Obligations of Contracts.” (“Contract clause”) Most states, but not all, have general contract clauses that are analogous to the federal Contract Clause. The majority approach is that pension benefits are contractual in nature.
- C. **Internal Revenue Code** - If the Plan intends to be a “qualified plan” under Section 401(a) of the Internal Revenue Code (“IRC”), in order to enjoy tax-exempt status under IRC § 501(a), the Plan must meet many IRC requirements. However, governmental plans are also exempt from many of the IRC requirements that apply to non-governmental plans.
- D. **ERISA** - Governmental plans² are exempt from most key provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”): (1) Title I of ERISA³ which deals with mandatory requirements for pension plans, (2) Title IV of ERISA⁴ dealing with plan termination insurance, and (3) certain tax provisions in Title II that were made inapplicable to governmental plans.

¹ Thanks to Rachel Cohen of the Maryland State Retirement & Pension System for her excellent work in developing this outline.

² “Governmental plan” is defined in ERISA § 3(32); 29 USC § 1002(32); and in IRC § 414(d) (26 U.S.C. § 414(d)).

³ ERISA § 4(b)(1); 29 U.S.C. § 1003(b)(1).

⁴ ERISA § 4021(b)(2); 29 U.S.C. § 1301(b)(2).

Title II of ERISA amended the IRC and includes certain Plan qualification requirements that do apply to governmental plans. Although governmental plans are not subject to certain portions of ERISA, the majority of states have enacted fiduciary standards that are almost identical to the ERISA standard. ERISA is administered by the Department of Labor.

- E. **ADEA, ADA, and USERRA** - Governmental plans are subject to many other provisions of federal law, including but not limited to the Age Discrimination in Employment Act (“ADEA”), the Americans with Disabilities Act (“ADA”), the Uniformed Services Employment and Reemployment Rights Act (“USERRA”), the Civil Rights Act, and the Family and Medical Leave Act (“FMLA”).

Sovereign Immunity

Note that *state*-sponsored plans may have sovereign immunity from a private cause of action under a federal law such as the ADEA (where the legislation was not enacted by Congress under the 14th amendment). *Kimel v. Florida Bd. of Regents*, 120 S. Ct. 631, 650 (2000). Sovereign immunity is not available from an EEOC enforcement action under the ADEA.

II. DEFINED BENEFIT PLANS vs. DEFINED CONTRIBUTION PLANS

A. Defined Benefit Plan (“DB Plan”)

1. The employee receives a specific amount of money at retirement, and the Plan describes how that amount (the “defined benefit”) is calculated. The amount is based on a formula, typically a percentage of final average salary multiplied by years of service. The amount of the benefit is NOT determined by the dollars contributed by the employee, the employer, or the investment return.
2. Advantages
 - Permit employees to project monthly retirement income with certainty
 - Benefits paid at least for life of the retiree
 - Substantial payments possible for early death or disability due to pooling of assets
 - Economical – a dollar of benefits can be delivered to a retiree under a defined benefit plan at roughly half the cost of a defined contribution plan. (Source: National Institute on Retirement Security: “A Better Bang for the Buck” 2008)
 - Retains employees with seniority

3. Disadvantages

- Employer bears the risk and the responsibility for the adequacy of trust assets.
- Lack of portability
- Provides little benefits for short-term employees.

B. Defined Contribution Plan (“DC Plan”)

1. An employee has an individual account into which employer and/or employee contributions are deposited. The Plan describes the contribution to be made by the employer or employee, or both, to the employee’s account, as opposed to the benefit, e.g. 6% of pay (the “defined contribution”) When the employee retires, the amount of the benefit is determined by the amount of contributions and the investment earnings in the account.

2. Advantages

- The employer does not bear the responsibility for adequacy of trust assets – the risk is transferred to the employee
- Easy to understand
- Compounding investment returns allows savings to grow
- Very portable

3. Disadvantages

- Few individuals save enough money for retirement
- Few individuals have sufficient expertise to choose their investment options well/plan may offer limited investment options
- Because monies are held in individual accounts, the plan cannot provide effectively for early disability or death

C. **Hybrid plan** – e.g., a Cash balance plan. A hybrid combines defined benefit and defined contribution elements in a single plan.

III. BENEFITS 101: WHAT IS (OR IS NOT) IN YOUR PLAN DOCUMENT?

A. **Membership** – The plan document should describe who is entitled or required to participate in the Plan, and may also provide specific exclusions or exemptions from membership. In a multiemployer plan, the plan document will also discuss who is an eligible employer. The Plan may exclude part-time, temporary or contractual employees, and may provide optional membership for elected or appointed officials. The IRS position is that only employees of a governmental employer may be members of a governmental plan.

- B. Service credit** – The Plan should describe how employment time accrues in the Plan. Issues may include how part-time service is calculated, the counting of service for school year employees, dual employment, employment interruptions including FMLA leave or military leave, unused sick leave.
1. **Purchases of Service Credit** – Public plans may allow employees to purchase additional years of service credit. The service credit may represent certain years of service the employee had with the current employer or a previous government employer. Credit can often be purchased for the following employment: Federal government, military service, out-of-state or in-state counties or municipalities, out-of-state teaching. IRC limits (26 U.S.C. § 415(n)) apply to purchases of service.
 2. **Military Service Credit** - USERRA (38 U.S.C. § 4318 and 20 C.F.R. § 1002.259) requires that on reemployment following an absence due to service in the uniformed services, the employee is treated as not having a break in service for purposes of participation, vesting and accrual of benefits. Reemployment rights under USERRA typically apply to cumulative periods of military service of up to 5 years. If public plan terms differ from USERRA, the Plan must apply whichever provision is more generous in the given situation.
- C. Salary** – The plan document should describe the compensation that is used to calculate pension benefits. May be limited to an employees' base salary for working the normal time in the member's position, excluding compensation in the form of: bonuses, overtime, honoraria, stipends, pay for coaching extra-curricular or summer activities. See 91 A.L.R.5th 225 – *What Constitutes "Salary, "Wages," "Pay," or the Like, with Pension Law Basing Benefits Thereon*. Typically, a Plan will pay benefits based on an "average final salary" taking into account a specified period of time (typically 3 or 5 years), either consecutive or non-consecutive, in which salary was highest.
- **Salary spiking**: the manipulation of final salary in final years of employment to enhance pension benefits in retirement. Salary spiking activities may include the payment of extraordinary salary increases, conversion of employer paid benefits into cash, adoption of "early notification programs" (e.g., a 10% add on to salary for notifying employer of retirement date). Some plans place caps on salary increases that will count towards average final salary (e.g. 10k or 10%), limit end of career add-ons.
- D. Vesting** – Many plans permit vesting prior to full retirement eligibility. A vested employee is entitled to receive a future benefit based on length of service. A vested allowance is not paid at the time of separation from service, but deferred

until a later date. In most DB plans, individuals are not vested until they have worked a minimum number of years, e.g. 5 or 10 years. The benefit will typically commence upon attainment of normal retirement age.

E. Normal Service Retirement - Eligibility for normal retirement benefits can be based on age, years of service, or age and years of service combined (e.g., Rule of 92 – the participant’s age combined with years of service equals 92). Early service may be provided, typically with a reduction. Service retirement benefits typically commence upon attainment of normal retirement eligibility and separation from employment. Plans should consider the IRC’s requirements regarding normal retirement age. New guidance was issued in April, 2012 regarding the normal retirement age regulations.

F. Calculation of Retirement Benefit - Based on a formula:

$$\frac{\text{Average Final Salary}}{\text{(average of the highest years of earnings)}} \times \frac{\text{Months/Years of Service}}{\text{(service credit earned)}} \times \frac{\text{Multiplier}}{\text{(a specific percentage adopted by the plan sponsor)}}$$

1. Average Final Salary – Generally based on a set number of years, depending on the Plan provisions, e.g. 3 or 5 highest years of earnings.
2. Months of Service – Service credit is earned for each month the individual meets the employer’s requirements for days/hours worked. A cap may apply.
3. The multiplier may vary from system to system and within the same system for different periods of time, depending on the Plan provisions.

G. Retirement Benefit Options - Choices at Retirement

1. Single life annuity – Benefits are paid over the life of the retiree; when the retiree dies, the payments cease. There is no benefit reduction to support a single life annuity. This is also referred to as a “straight life annuity.”
2. Dual life annuity – A benefit is paid over the life of the retiree, and, upon the retiree’s death, a continuing monthly benefit is paid for the life of the surviving beneficiary (e.g. spouse). The continuing monthly benefit due to the survivor is usually 50% or 100% of the annuity provided to the retiree. This is also referred to a “joint and survivor annuity.”
3. For a dual life annuity, generally, the benefit paid over the life of the retiree is reduced in order to “pay” for the survivor annuity that begins on the death of the retiree. Some plan provisions, often police plans, are designed to subsidize an

annuity for a retiree's spouse, meaning that there is no reduction in the benefit paid to the retiree to "pay" for the survivor benefit.

4. Alternate options may be available, including lump sum distributions to surviving beneficiaries.

H. Reemployment after retirement – A Plan may provide for suspension of retirement benefits, an earnings limit (reduction in retirement benefits if the retiree earn a salary that exceeds a specified limit), and/or prohibition against future benefit accruals. State statutory provisions may be designed to ensure bona fide separation from employment before commencement of retirement (e.g., prohibition against return to work within a specified time period).

I. Other benefits – A Plan may provide employee death benefits, line of duty death benefits, disability retirement, return of accumulated contributions, cost of living adjustments (COLA).

J. Deferred Retirement Option Plan ("DROP")

1. A DROP is an arrangement under which an employee who is eligible to retire can receive deferred benefits while continuing to work.
2. The DROP member "retires" but continues to work. The retirement benefit is based on years of service and salary before entry into DROP. Salary increases and years of service while in DROP are not taken into account.
3. While the DROP member continues to work, the monthly retirement benefit is paid into the individual's DROP account maintained by the Plan, rather than being paid to the participant; DROP funds accumulate and earn interest
4. The length of DROP participation is usually limited to several years. Once DROP participation ends, the funds accumulated in the member's DROP account are distributed to the member, and member separates from employment.
5. Some have raised ADEA concerns with respect to DROPs. In *Lerman v. City of Fort Lauderdale*, No. 02-60967-CIV, 2008 WL 5378127 (S.D. Fla. Dec. 23, 2008)(unpublished), *aff'd*, 346 Fed. Appx. 500 (11th Cir. 2009), *cert. denied*, 130 S. Ct. 1543 (2010), certain veteran police officers challenged a DROP under the ADEA, alleging it discriminated on the basis of age. *Id.*, 2008 WL 5378127, at *4-5. Citing the "safe harbor" for voluntary early retirement incentive plans (29 U.S.C. § 623(f)(2)(B)), the court determined that DROP conformed to the ADEA because the program was "completely voluntary" and "fit[] within the purpose of the ADEA" by creating an incentive for officers to retire early. *Id.*, at *13.

IV. LIENS/ANTI-ALIENATION

- A. **Anti-Alienation Generally** – Governmental plans are not subject to IRC § 401(a)(13), requiring that plan benefits may not be assigned, attached, garnished or alienated. 26 CFR § 1.401(a)-13(a). Nonetheless, governmental plans generally contain provisions to limit or prohibit the attachment, garnishment, execution or seizure of any current or future benefit. If the plan itself or relevant statutes do not contain anti-alienation provisions, state spendthrift laws may also apply to protect the participants' benefits.
- B. **Private Garnishment.** Typically, a Plan will prohibit garnishment or attachment of pension benefits by a private party. However, U.S. tax liens are exempted from any anti-alienation provisions (IRC § 2631), and state tax liens are often exempted as well.
- C. **Child Support Orders** – Typically, a Plan will permit garnishment of benefits to satisfy an order of child support. Note the provisions of Federal Consumer Credit, Protection Act which prevent garnishment of more than 50-65% of retiree's benefit for child support (% cap depends on whether retiree is supporting a current spouse/child and whether there are any arrearages to be recovered). See 15 U.S.C. § 1673; 29 CFR § 870.11.
- D. **Domestic Relations Orders ("DRO") other than Child Support**
1. As defined by federal tax law (IRC § 414(p)(1)(B)), a domestic relations order is a court order (not an agreement) made pursuant to state domestic relations law that provides marital property rights, alimony, or child support to a participant's spouse, former spouse, child or other dependent.
 2. Governmental plans are not required to recognize a Qualified Domestic Relations Order (QDRO) under ERISA, because ERISA's requirements regarding QDROs (ERISA § 206(d)(3)) do not apply to governmental plans. However, if a plan makes distributions under a DRO that meets the IRC's definition of a qualified domestic relations order under IRC § 414(p), tax consequences are determined by federal tax law.
 3. Many states require governmental plans to recognize a DRO. Even where state law does not provide for recognition of a DRO by a Plan, some courts have held that the division of pension benefits in a divorce is not an alienation or assignment of a retirement plan benefit and should be honored by a governmental plan.

4. To prevent confusion, most governmental plans do not use the phrase QDRO. Governmental plans have their own terminology, e.g., “Plan Approved Domestic Relations Order” (“PADRO”) or “Eligible Domestic Relations Order” (“EDRO”), and establish their own processing rules.
5. Typical state and local governmental plan provisions may provide that an EDRO is a court order that:
 - a. Assigns to the alternate payee a right to receive all or a portion of the participant’s benefit.
 - b. Specifies a fixed or determinable amount due to the alternate payee. May be a flat percentage, flat dollar amount, percentage of a marital share fraction (numerator is months of marriage during which participant accumulated benefits/denominator is months of service credit)
 - c. In Maryland, specifies that benefits may be paid to alternate payee only “if, as and when” a benefit is paid to the member. The alternate payee does not have the option to receive distributions at a different time or designate a beneficiary.
 - d. Does not require the plan to pay an amount that exceeds participant’s benefit
 - e. Does not require the plan to provide any type or form of benefit, or any option, not otherwise provided under the plan.
 - f. Does not require the payment of benefits to an alternate payee which are required to be paid to another alternate payee under a previous order.
6. The DRO should address all potential plan benefits that may become payable to the participant:
 - a. Monthly Allowance
 - b. Pre-retirement death benefits
 - c. Post-retirement survivor benefits
 - d. Cost of living adjustments
 - e. Return of accumulated contributions
7. Model Domestic Relations Orders – Many governmental plans find it convenient to provide a model order to avoid the time and expense of rejecting defective court orders. The model should explicitly state that it should not be taken as legal advice, and is presented for informational purposes for use by counsel, only to assist in the submission of a DRO that may be found acceptable to the plan administrator.

V. DEALING WITH ERROR CORRECTIONS

- A. Under the IRC, a qualified plan is required to be administered in accordance with the written plan document.

B. Many plans have a provision requiring correction of errors: “If, because of an error in the records, a retiree or beneficiary receives a benefit that differs from the benefit the retiree or beneficiary is entitled to receive, the plan shall correct the error.”

C. Estoppel – a participant may argue that the error should not be corrected based on principles of estoppel: The participant may argue that the error resulted from (a) the Plan employee providing information that the Plan knew or should have known was incorrect; (b) the information was reasonably relied upon by the member; (c) the member changed his/her position based on the information.

D. Governmental Exception to Estoppel: The government cannot be forced to do that which it has no authority to do.

1. *Office of Personnel Management v. Richmond*, 496 U.S. 414, 416, 110 S. Ct. 2465, 2467 (1990). The claimant in *Richmond*, a Navy welder, received erroneous advice regarding a statutory limit on earnings that would disqualify him from a disability annuity, and lost six months of benefits. The claimant argued that the bad advice should give rise to equitable estoppel against the government, and should entitle him to payment of the benefits in accordance with the advice he received, contrary to the statutory terms. The U.S. Supreme Court recognized that estoppel does not lie against the government as it lies against private litigants, and explained that not even the temptations of a hard case will provide any basis for ordering a recovery contrary to the terms of a statute. *Id.* at 420, 110 S. Ct. at 2469. To do so, said the Court, would disregard “the duty for all courts to observe the conditions defined by Congress for charging the public treasury.” *Id.*, quoting *Federal Crop. Ins. Corp. v. Merrill*, 332 U.S. 380, 68 S. Ct. 1 (1947). The Court stated that:

Extended to its logical conclusion, operation of estoppel against the Government in the context of payment of money from the Treasury could in fact render the Appropriations Clause a nullity. If agents of the Executive were able, by their unauthorized oral or written statements to citizens, to obligate the Treasury for the payment of funds, the control over public funds that the Clause reposes in Congress in effect could be transferred to the Executive.

496 U.S. at 428, 110 S. Ct. at 2473.

2. Governmental exception to estoppel is often recognized by state courts, and there is state law precedence with respect to governmental pension plans. *E.g.*, *Employees’ Retirement System v. Melton*, 294 Ga. App. 634 (2008); *Strong v.*

State ex rel. Oklahoma Police Pension and Retirement Board, 115 P.3d 889 (Okla. 2005). However, members may have a tort claim for consequential damages even if the Plan must correct the error.

- E. Certain factors will affect the likelihood of a court upholding a Plan's decision to correct. A court may not uphold a decision to correct if the statute is ambiguous and susceptible to interpretation in favor of the member's position.
- F. **ECPRS** - With regard to correction by a plan of IRC compliance errors (which does contemplate errors on an individual participant's benefit), IRS has issued Revenue Procedure 2013-12 (find it at <http://www.irs.gov/pub/irs-drop/rp-13-12.pdf>) introducing the Employee Plans Compliance Resolution System ("ECPRS") that provides a comprehensive system of correction programs for sponsors of qualified plans under IRC §§ 401(a), 403(a), 408(k) or 408(p), but that have not met the relevant requirements for a period of time. The three programs comprising ECPRS are, in increasing level of complexity and cost, the Self-Correction Program (which should cover the vast majority of individual participant benefit errors), the Voluntary Correction Program, and the Audit Closing Agreement Program.

VI. ACTIONS BY GUARDIANS AND AGENTS UNDER A POWER OF ATTORNEY

- A. **Powers of Attorney** – A power of attorney is a basic financial planning tool through which a person can authorize another individual to take certain actions with respect to property and assets on their behalf during their lifetime. The POA establishes a fiduciary relationship between a principal (the participant) and an agent (sometimes referred to as the "attorney-in-fact"). Many financial institutions and agencies review such documents on a daily basis.
 - 1. State law governs whether a plan administrator may or must permit the actions of an agent under a power of attorney.
 - 2. Scope of authority of a power of attorney is typically controlled by the language of the power of attorney.
 - 3. The agent is a fiduciary with duties of care and loyalty. Unless power of attorney expressly permits agent to make beneficiary designation, under state law, a plan administrator should consider whether to decline a beneficiary designation made by an agent under a POA. A beneficiary designation is a form of gifting of the assets of the principal, and under State law, may be required to be explicitly authorized. A plan administrator may also wish to consider whether a POA should explicitly authorize self-designations by an agent.

4. A plan administrator should develop best practices with legal counsel for the review and approval of actions by an agent under a POA.
5. Best practices might include: (a) a checklist or other screening tool for staff to use to review POAs and approve basic transactions performed by an Agent; (b) training selected staff to review POAs; (c) a process to identify potential problem POAs and forward to legal counsel for review.
6. POAs that require special attention may include: (a) out of state POAs (many state laws require that POA satisfy the execution formalities of home jurisdiction); (b) Designations of beneficiary by a POA; (c) springing POAs; (d) POAs submitted by dual agents; (e) non-durable POAs; (f) limited POAs.

B. Guardianship Orders – A guardian is an individual appointed by the court for the benefit of a minor or disabled person (person who has been determined to be unable to manage his or her affairs). A guardian serves in a fiduciary capacity, under the court's supervision, and must account for his actions with the court.

1. Plan administrators should look to state law and the terms of the guardianship order to determine whether a particular action requested by a guardian is authorized.
2. In many jurisdictions, a guardianship order typically does not include authority to change beneficiary designations. Court approval would be needed.
3. Plan administrators should develop best practices with legal counsel for the review and approval of actions requested by a guardian.
4. Best practices may include: (a) requiring true-test copy of guardianship order; (b) checking docket to ensure order is still in effect; (c) determining whether all requirements have been met by guardian (e.g., did guardian furnish bond, submit any required accounting to court).

ARE YOU QUALIFIED?

Protecting the System's Qualified Status and Providing the Best Tax Treatment for Members' Benefits

Terry A.M. Mumford

March 1, 2014

IceMiller
LEGAL COUNSEL

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§401(a)

~~ARE YOU QUALIFIED?~~

**Protecting the System's Qualified Status and Providing the
Best Tax Treatment for Members' Benefits**

I. Role of the System Counsel or Compliance Officer

A. Type of Plan

1. Most governmental retirement systems have been established and maintained as qualified governmental plans under the Internal Revenue Code ("Code") Section 401(a). In order to protect that status and provide favorable tax treatment for members' benefits, counsel should be aware of qualification requirements.
2. The sources of requirements for a qualified plan include:
 - a. The Code as amended by Congress. See Attachment A.
 - b. Treasury Regulations, interpreting the Code.
 - c. Revenue Procedures.
 - d. Revenue Rulings. For example, the IRS has dealt with pick-ups primarily with revenue rulings.
 - e. Notices.
 - f. Other – Announcements, Newsletters, Court Decisions (*United States v. Windsor*).
3. Alternative plans include:
 - a. 457(b) - Deferred Compensation – See Final Regs and model language.
 - b. 403(b) - Tax Sheltered Annuities – See Final Regs and model language. See also Rev. Proc. 2013-22 (procedures for issuing opinion and advisory letters for 403(b) pre-approved plans).
 - c. "Non-qualified Plans" – 457(f) and 409A.

B. Plan Document

1. Plan document must be identified (constitution, statutes, rules).
2. Qualified plan must be administered in accordance with plan document.

3. Plan document must contain required tax compliance language.

II. Why is Qualification So Important?

A. Taxation

1. Employer contributions are not taxable to members as the contributions are made (or even when vested); taxation only occurs when plan distributions are made.
2. Earnings and income are not taxed to the trust or the members (until distribution).
3. Certain favorable tax treatments may be available to members when they receive plan distributions, for example, the ability to rollover eligible distributions.
4. Employers and members do not pay employment taxes (even if the positions are Social Security covered) when contributions are made or when benefits are paid.
5. Tax recapture available for qualified plans in tax treaty countries.

B. Bankruptcy

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCA") provides greater protection for retirement funds, including IRAs, that qualify for favorable federal tax treatment.

III. Why is it So Important to be a Governmental Plan?

A. Exemption from ERISA

1. Governmental plans are exempt from the Employee Retirement Income Security Act of 1974 ("ERISA"). Exemption from Title I is found in Section 3(32) of ERISA.
2. Governmental plans are exempt from Pension Benefit Guaranty Corporation ("PBGC") premium payments. Exemption from Title IV is found in Section 4021(b)(2).

B. Limited Application of Code

1. Code Section 401(a) currently has 37 separate paragraphs, each setting forth a qualification requirement. However, governmental plans are exempt from many Code requirements, including many time consuming and costly testing requirements. See flush language at end of Code Section 401(a). See attachment.

2. Code Section 414(d) defines a government plan for Code purposes.
3. The Treasury, IRS, DOL and PBGC are meeting to work out a consistent interpretation of "governmental plans" for all purposes. The Departments issued an advanced notice of proposed rulemaking ("ANPRM") which would define "governmental plan."
 - a. IRS has taken the position that no non-governmental employees or employers may participate in governmental plan.
 - b. DOL has permitted a de minimis number of non-governmental employees.

C. Special Favorable Code Provisions

1. Employee contributions may be "picked-up" and thereby treated as pre-tax when contributions are made. (Code Section 414(h)(2))
2. State and local government plans have favorable grandfathering and transitional rules under IRS guidance. (See, for example, final 415 regulations or 401(a)(17) limits)
3. Special limits on benefits that are more favorable apply to governmental plans. (Code Section 415(b), for example)
4. Special service purchase opportunities exist only for governmental plans. (Code Section 415(n), for example)

IV. How Does Counsel Know For Sure that Its Plans are Qualified?

- A. The IRS issues "determination letters" which confirm the qualified status of a retirement plan.
1. Form 5300 is the IRS application form.
 2. IRS has adopted staggered remedial amendment periods (Rev. Proc. 2007-44).
 - a. Cycle C is for governmental plans (the second Cycle C ended January 31, 2014; the next Cycle C will be February 1, 2018 – January 31, 2019).
 - b. IRS gave sponsors of individually designed governmental plans the option of electing to use either Cycle C (February 1, 2013 – January 31, 2014) or Cycle E (February 1, 2015 – January 31, 2016) as their second remedial amendment cycle (Rev. Proc. 2012-50).
 - c. Notice 2013-84 Cumulative list (applies for Cycle D).

- d. Interim and discretionary amendments.
 - e. IRS adopted extended remedial amendment period for governmental plans that receive favorable determination letter. (Rev. Proc. 2009-36).
3. "Off-cycle" filings are discouraged.
- B. For issues related to governmental plan status and the taxation of contributions and benefits, the IRS issues "private letter rulings." PLRs only bind the IRS with respect to the taxpayer to whom the letter is issued.
 - C. Each year the IRS issues revenue procedures setting forth procedures and fees. (See Rev. Proc. 2014-1 through 2014-8).
 - D. Certain compliance failures may be addressed through self-correction or IRS approved correction in "EPCRS." (Rev. Proc. 2013-12)

V. Definitions

- A. Basic Definition: What is a Pension Plan?
 - 1. Plan must be established and maintained by an employer or employers for employees. (Code Section 401(a)(1); Rev. Rul. 72-240, 1972-1 C.B. 108)
 - 2. Each plan's assets must be held in trust as determined under state law. (Code Section 401(a)(1))
 - 3. Trustees must exercise fiduciary duties. (Code Section 401(a)(2))
 - 4. Plan must be established primarily to provide systematically for the payment of definitely determinable benefits.
- B. Other Definitions to Consider -- Code Section 414

Code Section 414 contains many definitions that must be considered including:

 - 1. Code Section 414(d) -- Governmental Plan.
 - 2. Code Section 414(g) -- Plan Administrator.
 - 3. Code Section 414(h) -- Tax Treatment of Certain Contributions ("Pick-Ups").
 - 4. Code Section 414(i) -- Defined Contribution Plan.
 - 5. Code Section 414(j) -- Defined Benefit Plan.
 - 6. Code Section 414(k) -- Certain Plans ("Hybrid Plan").

7. Code Section 414(n) – Employee Leasing.
8. Code Section 414(p) – Qualified Domestic Relations Order.
9. Code Section 414(s) – Compensation.
10. Code Section 414(u) – Special Rules Relating to Veterans' Reemployment Rights under USERRA.
11. Code Section 414(v) – Catch-up Contributions for Individuals Age 50 or Over.
12. Code Section 414(w) – Special Rules for Certain Withdrawals From Eligible Automatic Contribution Arrangements.
13. Code Section 414(x) – Special Rules for Eligible Combined Deferred Benefit Plans and Qualified Cash or Deferred Arrangements ("DB/k Plan").

C. Pension Plan: Areas of Inquiry

1. General
 - a. Medical benefits. (Treas. Reg. Section 1.401-14; Code Section 401(h))
 - b. In-service distributions, including refunds of contributions during employment. (Treas. Reg. Section 1.401-1(a)(2)(i)).
 - i. PPA permits certain in-service distributions if plan so provides. (Code Section 401(a)(36))
 - ii. IRS issued final regulations on normal retirement age. Treas. Reg. Section 1.401(a)-1(b); Notice 2007-69. Final regulations do not apply to governmental plans until 2015 (at the earliest) (Notice 2012-29).
 - c. Statement of actuarial assumptions. (Code Section 401(a)(25))
 - d. Death and disability benefits ("incidental benefits"). (Treas. Reg. Section 1.401-1(b)(1)(i))
2. Some Special Issues
 - a. 13th checks.
 - b. DROP plans.
 - c. Compliance with 401(h) requirements for medical benefits.

- i. Only means of paying medical benefits from pension plan.
- ii. Limited to retiree, spouse, dependents.

VI. Exclusive Benefit Rule

A. Code Requirements

1. The plan must be established and operated for the exclusive benefit of employees and their beneficiaries.
2. The plan must make it impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries . . . for any of the corpus or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of employees or their beneficiaries (Code Section 401(a)(2))

B. Exclusive Benefit Rule: Areas of Inquiry

1. Payments to other than the members and their survivors.
2. Investments that do not meet fiduciary standards.
3. Diversion of assets.
4. Return of contributions to employer.
5. QDROs – Code Section 414(p).
6. Garnishment.

VII. Prohibited Transactions

A. The plan may not engage in "prohibited transactions." (Code Section 503(b))

B. Prohibited Transactions: Areas of Inquiry

1. Self-dealing in investments.
2. Loans.

VIII. What Type of Qualified Plan is it?

- A. A defined contribution plan. (Code Section 414(i))
- B. A defined benefit plan. (Code Section 414(j))
- C. A hybrid defined benefit plan. (Code Section 414(k))

IX. Who Can be a Member?

A. To maintain qualified governmental status:

1. Only employees of governmental employers may be members of the plan. (IRS position)
2. Only contributions from these employers and their employees may be made to the plan. (Code SectionSection 401(a)(1) and 414(d))

B. Governmental Plan Status: Areas of Inquiry

1. Privatization.
2. Coverage of non-governmental entities; coverage of non-governmental employees (union representatives; see Code Section 413).
3. Cooperatives.
4. Contracting Out and In.
5. Charter Schools.
6. Utility Districts.
7. Volunteer Fire Companies (See Code Section 457(e)(11)(A)(ii)).
8. Indian Tribal Governments.

X. Mandatory vs. Optional Membership

A. If the plan (defined contribution or defined benefit) provides for optional participation, the option must be a one-time irrevocable election or a grandfathered cash or deferred arrangement. (Rev. Rul. 2006-43; Code Section 401(k); Treas. Reg. Section 1.401(k)-1(a)(3)(v))

B. Membership Options: Areas of Inquiry

1. Optional participation.
2. Ongoing or revocable elections.
3. Transfers to another plan maintained by the employer.
4. "Special Pay" Plans.

cycle C & E - next cycle 2/1/15 gov plan can file for deto/deter

XI. Vesting

A. Code Requirement

1. Governmental plans are subject to pre-ERISA vesting rules – "the vesting requirements resulting from the application of Sections 401(a)(4) and 401(a)(7) as in effect in September 1, 1974." (Code Section 411(e))
2. Plan must provide 100% vesting if there is a partial or complete termination of the plan, or complete discontinuance of contributions, but in either situation only to the extent benefits are funded. (Treas. Reg. Section 1.401-6)
3. Pre-ERISA vesting would also require 100% vesting of accrued benefit at normal retirement age. (Rev. Rul. 66-11, 1966-1 C.B. 71)

B. Vesting: Areas of Inquiry

1. Spin-offs.
2. Privatization.
3. Implementation of benefit tiers.
4. Plan termination (in whole or in part).
5. Frozen plans.

XII. Limits on Contributions

A. Code Requirements

1. All annual additions to a defined contribution plan and post-tax employee contributions to a defined benefit plan are capped by the limit on "annual additions" to pension plan – the lesser of 100% of compensation or \$40,000 (adjusted for inflation by the IRS) (Code Section 415(c)) – \$52,000 for 2014.
2. Exceptions to these limits for permissive service credit purchases in a defined benefit plan. (Code Section 415(n); see PPA Section 821)
3. Restoration of withdrawals. (Code Section 415(k)(3))
4. If the employer plan provides for a pick-up of members' mandatory contributions, the pick-ups must be in compliance with IRS guidelines, and then will be tested under Code Section 415(b). (Code Section 414(h); Rev. Rul. 2006-43; see final 415 regulations)
5. Rollovers.

6. Transfers.
- B. Contribution Limits: Areas of Inquiry
1. Final 415 regulations. (April 5, 2007)
 2. Definition of Compensation. (Code Section 415(c)(3))
 3. Picked-up Contribution. (Code Section 414(h)(2); Rev. Rul. 77-462, 1977-2 C.B. 358; Rev. Rul. 81-35, 1981-1 C.B. 255; Rev. Rul. 87-10, 1987-1 C.B. 156; Rev. Rul. 2006-43, 2006-35 IRB 329)
 - a. Employer paying contributions in lieu of employee.
 - b. Employee has no option of receiving picked-up amounts.
 - c. Official action.
 - d. Timing of pick-up.
 - e. Irrevocable elections.

XIII. Limits on Benefits § 415(b)

- A. Code Requirements
1. Benefits from a defined benefit plan are subject to the "dollar limit" – \$160,000 (adjusted for inflation by the IRS) (Code Section 415(b)) – \$210,000 for 2014.
 2. Benefit tested as the straight life annuity. Benefits that are not paid as a straight life annuity must be converted for vesting purposes only using IRS required factors.
- B. Benefit Limits: Areas of Inquiry
1. Final 415 regulations.
 2. Service retirement with fewer than 10 years of service.
 3. Early retirement (Code Section 415(b)(2)(C)) – before age 62.
 4. Special limits for public safety employees. (Code Section 415(b)(2)(G)-(H))
 5. Post-retirement adjustments.
 6. Establishment of Qualified Excess Benefit Arrangement to handle excess benefits. (Code Section 415(m))

XIV. Limits on Compensation

A. Code Requirements

1. The plan must limit the compensation that may be considered to \$200,000 in determining benefits (as adjusted for inflation) (Code Section 401(a)(17)) – \$260,000 for 2014.
 - a. For employee contribution calculation (generally not for employer contribution purposes).
 - b. For benefit calculation.
2. Certain employees are grandfathered.
 - a. Look at plan provisions on July 1, 1993.
 - b. Participants who first joined prior to plan year beginning after December 31, 1995.
 - c. Timely amended for limits.

B. Compensation Limits: Areas of Inquiry

1. Plan Year vs. Calendar Year.
2. Year-by-year application.

XV. Required Benefit Payments

A. Code Requirements

1. The plan must set forth the Code's distribution requirements and contain statements that the plan will comply with those requirements notwithstanding any of the plan's distribution provisions. (Code Section 401(a)(9))
2. Benefit must be distributed or begin to be distributed by the required beginning date (RBD) – April 1 of the calendar year that follows the calendar year in which the participant attains 70½ or separates from service, whichever is later. (Code Section 401(a)(9)(C))
3. Benefits must be distributed over the period of life of the employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond life expectancy(ies)). (Code Section 401(a)(9)(A)(ii)).
4. Benefits must meet the post-retirement minimum distribution incidental benefit (MDIB) requirement. (Treas. Reg. Section 401(a)(9)-6, Q&A-2)

*Can't use
retirement
benefits for
generation
skipping*

re op plan, IRS doesn't allow e-est elect
lower benefit

5. IRS has issued final regulations under 401(a)(9) for defined contribution and defined benefit plans. (Treas. Reg. Section 1.401(a)(9)-1 through Section 1.401(a)(9)-9) PPA also establishes a good faith, reasonable compliance standard for governmental plans. (PPA Section 823)
6. Required minimum distribution rules under Code Section 401(a)(9) were suspended during calendar year 2009 for defined contribution plans. See Code Section 401(a)(9)(H), as added by WRETA Section 201(a).
7. The plan must provide that, for a participant who dies while performing qualified military service, the survivors of the participant are entitled to any additional benefits (such as accelerated vesting, ancillary life insurance benefits, or other survivor benefits contingent on termination of employment on account of death; but other than benefit accruals relating to the period of qualified military service) provided under the plan as if the participant had resumed and terminated employment on account of his or her death. (Code Section 401(a)(37), added by HEART Section 104(a)). See IRS Notice 2010-15.

B. Required Benefit Payments: Areas of Inquiry

1. Assuring that benefits begin by the required beginning date (RBD).
2. Assuring that the required minimum distribution (RMD) is made.
3. Tracking down participants and beneficiaries.
4. Testing survivor benefits under the incidental benefit rules.
5. Grandfathered provisions) and/or good faith, reasonable compliance.
6. Providing benefits for survivors of participants who die while performing qualified military service.

XVI. Rollovers *source/considerable IRS interest*

A. Code Requirements

1. The plan must provide for rollovers by employees and spouses and give the appropriate notices. (Code Section 401(a)(31)(A))
 - a. Following *United States v. Windsor*, the reference to spouse, originally defined by Section 3 of the Federal Defense of Marriage Act, P.L. 104-199 ("DOMA"), changed to include same-sex spouses.
 - b. Rev. Rul. 2013-17 provides that same-sex couples married in jurisdictions recognizing their marriage ("place of celebration" rule) would be treated as married for federal tax purposes.

- c. Notice 2014-19 provides that plans be operated to be in compliance with the *Windsor* decision as of June 26, 2013 and with Rev. Rul. 2013-17 as of September 16, 2013.
2. Rollovers are permitted out of and into:
 - a. qualified plans,
 - b. 403(b) plans,
 - c. governmental 457(b) plans, and
 - d. IRAs (See PPA Section 824 – Direct Rollover to Roth IRAs in 2008; see WRERA Section 108(d) – Removal of restrictions for rollovers to Roth IRAs for plan years beginning before 2010 and tax-free rollovers from a designated Roth account to a Roth IRA).
 3. PPA Section 829 permits qualified plan to provide for non-spouse beneficiary rollover to inherited IRA. WRERA Section 108(f) makes non-spouse beneficiary rollovers mandatory for plan years after December 31, 2009.
 4. Retirement plans are not required to accept all types of rollovers; these are permissive.
 5. Automatic rollovers to IRA are required for mandatory distributions over \$1,000 for missing or non-consenting participants. (Code Section 401(a)(31)(B))

B. Rollovers: Areas of Inquiry

1. Identifying eligible rollover distributions. (Code Section 402(c)(4))
2. Identifying eligible retirement plans. (Code Section 402(c)(8)(B))
3. Using rollovers for service purchases.
4. Maintaining limitations on in-service distributions.
5. Compliance with notice requirements. (Code Section 402(f); Treas. Reg. Section 1.402(f)-1); note IRS Notice 2009-68)
6. After-tax dollars. (See PPA Section 822; see WRERA Section 108(d))
7. Implementing non-spouse beneficiary rollover (required for plan years after December 31, 2009; see WRERA Section 108(f)).
8. Implementing Roth Rollovers. (See the American Tax Relief Act of 2012 which permits an in-plan Roth rollover for any amount held for the benefit

of an employee, whether or not that amount is otherwise eligible for distribution).

9. Implementing rollovers of lump-sum distributions from a defined contribution plan to a defined benefit plan, where such amounts are converted to an immediate annuity. (See Rev. Rul. 2012-4).

XVII. Group Trust

- A. A qualified plan may be invested in a group trust. Revenue Rulings 81-100, 2004-67, and 2011-1.
- B. Assets of qualified plans (401(a)), 457(b) plans, deemed IRAs (including Roth IRAs), 403(b)(7) custodial accounts, and 403(b)(9) retirement income accounts may be commingled for investment purposes.
- C. Revenue Ruling 2011-1 provides updated guidance:
 1. A governmental plan described in Code Section 401(a)(24) may also participate in a group trust. This includes both a governmental plan that provides pension benefits and a governmental plan that provides other employee benefits for retirees, such as retiree welfare benefits. Therefore, a governmental plan providing retiree welfare benefits will be treated as a Code Section 401(a)(24) plan and may invest in a group trust. This should allow many Code Section 115 and OPEB retiree health trusts to participate in group trusts.
 2. Each adopting entity must be tax-exempt under Code Section 501(a) or not subject to federal income tax.
 3. Each adopting entity must be part of a plan that satisfies an exclusive benefit rule (*i.e.*, it is impossible for any part of the corpus or income of the plan to be used for, or diverted to, purposes other than for the exclusive benefit of the plan participants and their beneficiaries).

XVIII. Taxation of Benefits

- A. The plan must follow Code and IRS guidance for tax withholding and reporting procedures, including the taxation of disability benefits.
- B. Numerous Code provisions including Section 72, 101(h), 104 and 402.
 1. Code Section 72 sets forth general rule that gross income includes income from annuities, and provides for the recovery of basis and for certain tax penalties.
 - a. Code Section 72(c) – Definitions.

- b. Code Section 72(d) – Special Rules for Qualified Employer Retirement Plans.
 - c. Code Section 72(e) – Amounts Not Received as Annuities.
 - d. Code Section 72(m) – Special Rules Applicable to Employee Annuities and Distribution Under Employee Plans.
 - e. Code Section 72(p) – Loans Treated as Distributions.
 - f. Code Section 72(t) – 10-Percent Additional Tax on Early Distributions from Qualified Retirement Plans.
- 2. Code Section 101(h) – Survivor Benefits Attributable to Service by a Public Safety Officer Who is Killed in Line of Duty.
 - 3. Code Section 104(a) – Line of Duty Disability Benefits.
 - 4. Code Section 402 – Taxability of Beneficiary of Employees' Trust
 - a. Code Section 402(a) – Taxation of a 401(a) trust distribution is subject to Code Section 72.
 - b. Code Section 402(c) – Rollovers.
 - c. Code Section 402(e) – Other Rules Applicable to Exempt Trusts.
 - d. Code Section 402(f) – Written Explanation to Recipients of Distributions Eligible for Rollover Treatment – "Safe Harbor Notice."
 - e. Code Section 402(g) – Limitation on Exclusion for Elective Deferrals.
 - f. Code Section 402(l) – Distributions from Governmental Plans for Health and Long-Term Care Insurance.
- C. Taxation: Areas of Inquiry
- 1. Treatment of line of duty death and disability benefits.
 - 2. Implementation of PPA, HEART, and WRERA.
 - 3. 1099-R compliance review.
 - 4. Withholding on nonresident aliens. – Form 1042-S

CIRCULAR 230 DISCLOSURE

Except to the extent that this advice concerns the qualification of any qualified plan, to ensure compliance with recently-enacted U.S. Treasury Department Regulations, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including any attachments, is not intended or written by us to be used, and cannot be used, by anyone for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing, or recommending to another party any tax-related matters addressed herein.

This publication is intended for general information purposes only and does not and is not intended to constitute legal advice. The reader must consult with legal counsel to determine how laws or decisions discussed herein apply to the reader's specific circumstances.

ATTACHMENT A

BASIC PLAN QUALIFICATION REQUIREMENTS FOR A GOVERNMENTAL DEFINED BENEFIT 401(a) PLAN

LIST OF CODE SECTIONS APPLICABLE TO GOVERNMENTAL PLANS

Code Requirement

DEFINITION OF INTERNAL REVENUE CODE

The Internal Revenue Code should be defined in the Plan in accordance with state drafting rules.

Code Section 401(a)(1)

Formal Plan Required. A qualified plan that allows contributions to a trust for the sole purpose of distributing benefits to employees and beneficiaries with favorable tax treatment must be written. Contributions may be made only by (i) the employer, (ii) the employees, or (iii) both the employer and the employees. Plan must be administered in accordance with its terms.

"Pension Plan": a pension plan is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. Treas. Reg. Section 1.401-1(b)(1)(i).

Definitely Determinable Benefit: for a defined benefit plan, requirement is satisfied where the benefit (including disability, death and early retirement) for each participant can be computed in accordance with an express formula contained in the plan. Rev. Rul. 74-385; Treas. Reg. Section 1.401-1(b)(1)(i). See also Code Section 401(a)(25) (if benefit is determined on the basis of actuarial assumptions, such assumptions must be specified in plan so as to preclude employer discretion).

Mortality Tables. For a defined benefit plan, the IRS requires specific provisions setting forth the actuarial assumptions to be used in determining actuarial equivalence.

Incidental Benefit rules (non-retirement benefits, e.g., disability and death benefits). Treas. Reg. Section 1.401-1(b)(1).

Code Section 401(a)(2)

Exclusive Benefit to Employees. All qualified plan assets must be used exclusively for the benefit of employees or their beneficiaries. This rule involves a review of both form and operation.

In order to comply with this "exclusive benefit" rule, it must also be shown that not only are payments made solely to members and their beneficiaries, but also that payments made to beneficiaries are incidental to those payments made to the member.

Nondiversion of Trust Funds: Plan must make it impossible prior to satisfaction of all liabilities for funds to be diverted for purposes other than exclusive benefit of employees or beneficiaries. Treas. Reg. Section 1.401-2(a)(2).

No In-Service Distributions: Generally, a member may not receive distributions from a qualified plan prior to death, disability, separation from service, termination of plan, or attainment of normal retirement age.

Note: Code Section 401(a)(36) and IRS Final Regulations on Normal Retirement Age. Treas. Reg. Section 1.401(a)-1(b).

Code Section 401(a)(7)

Vesting Requirements. Pre-ERISA minimum vesting standards, requiring 100% vesting upon retirement and upon plan termination or discontinuance of employer contributions, must be met.

- Rev. Rul. 66-11: Requires full vesting at normal retirement age and completion of required years of service.

Code Section 401(a)(8)

Forfeitures. Forfeitures may not be used to increase plan benefits in a defined benefit plan.

- Treas. Reg. Section 1.401-7. Forfeitures may be used for plan expenses or to offset employer contributions.

Code Section 401(a)(9)

Required Distributions. Governmental plans must make distributions to an employee no later than April 1 of the calendar year in which he or she attains age 70½ or in which he or she retires, if later. The basic rule is that such distributions must be over the life of the employee or over the lives of the employee and a designated beneficiary or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary. If an employee dies before his/her entire interest is distributed, the remaining portion must be distributed at least as rapidly as under the method of distribution being used at the date of death. If an employee dies before distribution of his/her interest has begun, the entire interest must be distributed over the beneficiaries lifetime or within 5 years after the employee's death. There are limited exceptions to the 5-year rule, and special rules if the surviving spouse is the designated beneficiary.

Code Section 4974 provides a penalty for failure to make minimum distribution.

Note: Final Regulations provide for transitional period and grandfathering of certain benefits, as well as good faith, reasonable interpretation by governmental plans.

Code Section 401(a)(16)

Benefits or contributions may not exceed 415 limits. See 415 discussion below.

Code Section 401(a)(17)

Maximum Compensation. For years beginning after December 31, 2001, the compensation limit will be increased to \$200,000 and indexed thereafter in \$5,000 increments as determined by the IRS. Certain governmental employees who qualify as eligible participants are grandfathered to limit in effect under plan on 7/1/93.

Code Section 401(a)(24)

Participation in Group Trusts. A group trust can remain tax-exempt while accepting funds from a governmental plan or government maintained 457(b) plan or accepting funds intended to satisfy governmental obligations with respect to such plans.

Code Section 401(a)(25)

Stated Actuarial Assumptions. Whenever the amount of any benefit is determined on the basis of actuarial assumptions, a defined benefit plan must specify actuarial assumptions in a manner that precludes employer discretion in order to provide definitely determinable benefits.

Code Section 401(a)(31)

Eligible Rollover Distribution. This section requires a plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover. For distributions made after December 31, 2001, plans must permit participants to rollover account balances to 401(a) plans, 403(b) tax-sheltered annuities, and 457(b) governmental deferred compensation plans. In addition, rollovers may be allowed from traditional 401(a) plans, 403(b) plans, 457(b) governmental plans, and IRAs to these employer retirement plans. After-tax contributions in qualified plans may be rolled over to defined contribution and defined benefit plans and 403(b) plans that will account for them separately or to IRAs. Surviving spouses must be permitted to rollover distributions to a qualified plan, 403(b) plan, 457 plan, or IRA. Starting in 2007, non-spouse rollovers must be made to inherited IRAs. Starting in 2008, rollover to Roth IRA must be offered by qualified plan. Also, the law provides a hardship exception to the requirement that rollovers be made within 60 days of distribution, permitting the IRS to waive the 60 day requirement if the failure to do so would be against equity or good conscience.

Notes: Code Section 402(c) provides total and partial rollover and distribution rules, and general tax rules. Code Section 402(f) establishes a notice requirement and Code Section 6652 sets a penalty for failure to give notice.

Code Section 401(a)(36)

In-Service Distributions. Added by PPA Section 905. Final Regulations were published on May 22, 2007, clarifying that a pension plan (a defined benefit plan or money purchase pension plan established under Internal Revenue Code Section 401(a)) may be designed to allow the

payment of benefits when an employee reaches normal retirement age but has not yet terminated employment. The final regulations then address three age ranges and establish a "safe harbor" for a plan with a normal retirement age of age 62 or older. The final regulations also provide a special rule for pension plans in which substantially all of the participants are "qualified public safety employees." Pursuant to Notice 2009-86, the effective date of the Final Regulations for governmental plans is plan years beginning on or after January 1, 2013. Notice 2012-29 extended the effective date for governmental plans to plan years beginning on or after the later of (1) January 1, 2015 or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published in the Federal Register.

Code Section 401(a)(37)

Mandatory Survivor Benefits. In the case of a participant who dies while performing qualified military service (as defined in section 414(u)), the survivors of the participant are entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) provided under the plan had the participant resumed and then terminated employment on account of death. HEART Section 104(a).

Code Section 401(b)

Establishes required amendment periods for qualified plans. See Rev. Proc. 2007-44.

Code Section 401(h)

Retiree Medical Benefits. Pension or annuity plan may provide limited sickness, accident, hospitalization and medical benefits for retirees, their spouses and their dependents.

Code Section 401(k)

Cash or Deferred Arrangements. Governmental organizations generally cannot maintain a qualified cash or deferred arrangement. However, the Code contains an exemption for arrangements adopted by governmental plans before May 6, 1986. Those plans would have to conform to appropriate 401(k) provisions.

Optional participation in other retirement plans raises an issue as to whether such an option creates a cash or deferred arrangement, but the IRS regulations provide that a one-time irrevocable election by an employee to participate in a retirement plan, which election is available at the time of employment or at the time participation is first available, does not render a governmental plan a 401(k) plan.

Code Section 413

Collectively Bargained Plans and Multiple Employer Plans

Code Section 414(d)

Governmental Plan. Defined as "a plan established and maintained by its employees by ... the government of any State or political subdivision thereof, or by any agency or instrumentality of

any of the foregoing." The inclusion of non-governmental or quasi-governmental employers/employees can cause loss of governmental plan status.

Note: ANPRM issued 11/08/2011.

Code Section 414(h)

Government "Pick-ups". Allows a government entity to treat certain employee contributions as employer contributions. Revenue rulings have established the following requirements for an effective pick-up:

- The employer must take formal action, evidenced by a contemporaneous written document, specifying that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. A person duly authorized to take such action with respect to the employer must do so. The action must apply prospectively only.
- The employee must not be given the option, from and after the date of the pick-up, to have a cash or deferred election right (within the meaning of Treas. Reg. 1.401(k)-1(a)(3)) with respect to the designated employee contributions. Thus, the employees must not be able to opt out of the pick-up or be able to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

Rev. Rul. 2006-43; see also Rev. Rul. 81-35; Rev. Rul. 81-36; and Rev. Rul. 87-10.

Note: IRS approval obtained through PLR.

Code Section 414(i)

Definition of Defined Benefit Plan. A defined benefit plan means any plan that is not a defined contribution plan, *i.e.*, "a plan that provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and forfeitures of accounts of other participants which may be allocated to such participant's account." Code Section 414(i).

Code Section 414(n)

Leased Employees. Definitions for leased employees.

Code Section 414(p)

Definition of Qualified Domestic Relations Order. A distribution from a governmental plan, which is not subject to Code Section 401(a)(13), made pursuant to a domestic relations order will be treated as a QDRO if that order creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a plan. Code Section 414(p)(1)(A)(i) and (ii).

Note: Governmental plans are not required to accept QDROs. However, if plan does make distributions under DROs that meet this definition, the appropriate tax consequences are determined by federal law.

Code Section 414(u) and USERRA

Reemployed Veterans. The Uniformed Services Employment and Reemployment Rights Act of 1994 expanded veterans rights and included various retirement plan provisions in the Internal Revenue Code. Generally, make-up employee contributions required under DB plan not subject to 415 limits for year make-up contributions made, but subject to applicable limits for year to which the contributions relate.

- **HEART:** For years beginning after December 31, 2008, (1) an individual receiving a differential wage payment shall be treated as an employee of the employer making the payment; (2) the differential wage payment shall be treated as compensation for purposes of the limit on annual additions under Code Section 415(c) (and may be treated as compensation for purposes of contributions); and (3) the plan shall not be treated as failing to meet the Code Section 414(u)(1)(C) non-discrimination rule by reason of any contribution or benefit which is based on the differential wage payment.

Note: Final DOL Rules, IRS Notice 2010-15.

Code Section 415(b)

Limitations on Benefits. Effective for years ending after December 31, 2001, the benefit limit will increase to \$160,000, with future indexing for inflation in \$5,000 increments as determined by the IRS. Special rules regarding benefit reductions apply to governmental plans and particularly plans maintained for certain police and fire plans. Governmental plans are not subject to the benefit limitation based upon 100% of salary.

Note: Final IRS Regulations were issued in May 2007.

Code Section 415(c)

Limitations on Contributions. For years beginning after December 31, 2001, the annual additions limit is increased to the lesser of \$40,000 or 100% of compensation, with future indexing of the dollar limit for inflation in \$1,000 increments as determined by the IRS. The 415(c) limit is not applicable to picked-up contributions or the receipt of roll-over distributions.

Note: Final IRS Rules were issued in April 2007. Among the most significant changes were revisions to the definition of "compensation."

Code Section 415(k)(3)

Repayments. In case of repayment (including interest) to plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State, any such repayment shall not be taken into account for purposes of Code Section 415. After

December 31, 2001, a governmental defined benefit plan may permit a trustee-to-trustee transfer from a 403(b) plan or a 457 plan to purchase permissive service credit (see Code Section 415(n)) or to repay previously refunded contributions.

Code Section 415(m)

Excess Benefits. The 1996 federal legislation authorizes the establishment of Qualified Excess Benefit Arrangements to deal with benefits and contributions in excess of 415 limits.

Note: IRS approval obtained through PLR.

Code Section 415(n)

Service Purchases. Effective for 1998, there are modified 415(c) and 415(b) limits that apply to voluntary employee contributions for purchases of permissive service credit. After December 31, 2001, a governmental defined benefit plan may permit a trustee-to-trustee transfer from a 403(b) plan or a 457 plan to purchase permissive service credit or to repay contributions previously refunded under forfeiture of service credit (see Code Section 415(k)(3)). Note: 1997 legislation also establishes a transitional rule for eligible participants to grandfather purchases of service allowable as of 8/5/97.

Code Section 503(b)

Prohibited Transactions. While governmental plan is not subject to excise tax of Code Section 4975, engaging in prohibited transaction could result in loss of plan's tax-exempt status.

Code Sections 72, 101(h), 104, 402, and 3405

Governs taxation and withholding of various distributions from governmental plans.

LIST OF CODE SECTIONS NOT APPLICABLE TO GOVERNMENTAL PLANS

- Code Section 401(a)(3) Coverage Rules
- Code Section 401(a)(4) Nondiscrimination Rules
- Code Section 401(a)(5) Nondiscrimination Rules
- Code Section 401(a)(6) Nondiscrimination Rules
- Code Section 401(a)(10) and 416 Top Heavy Plans
- Code Section 401(a)(11) and 417 Joint and Survivor Rules*
- Code Section 401(a)(12) and 414(f) Plan Merger
- Code Section 401(a)(13) Anti-Alienation
- Code Section 401(a)(14) Benefit Commencement Rules
- Code Section 401(a)(15) Social Security Integration
- Code Section 401(a)(19) Forfeiture Rules
- Code Section 401(a)(20) Plan Termination
- Code Section 401(a)(26) Participation
- Code Section 401(a)(27) Profit Sharing Plans Only
- Code Section 401(a)(28) Employee Stock Ownership Plans
- Code Section 401(a)(29) 412 Plans Only
- Code Section 401(a)(30) Elective Deferrals (except for grandfathered plans)

Code Section 401(a)(32) and 401(a)(33) Bankruptcy and Funding Rules
Code Section 401(a)(34) PBGC Covered Plans
Code Section 401(a)(35) Defined Contribution Plans
Code Section 410 Participation
Code Section 411* (Instead See Pre-ERISA 401(a)(7))
Code Section 412 (Instead See Pre-ERISA 401(a)(7))

* Code Sections 411 and 417 must be considered for 415(b) testing under Final Regulations.

FIDUCIARY RESPONSIBILITY AND PENSION PLAN ADMINISTRATION

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NAPPA 2014 Legal Education Conference

2

INTRODUCTION

- Fiduciary considerations should be the guiding principle behind the actions of the Board of Trustees, both individually and collectively.
- The primary duty of a pension fund lawyer is to ensure that the trustees fulfill their fiduciary responsibilities and obligations to the members, retirees, and beneficiaries of the retirement system.

How Are Fiduciary Relationships Created/Defined?

- Law of Trusts – Restatement of Trusts (Third), 1992.
- By Contract (relationship of the parties).
- By statute
 - Federal Statutes – ERISA, 1974.
 - Uniform Prudent Investors Act (UPIA), 1994.
 - Uniform Management of Public Employees Retirement Systems Act (UMPERSA), 1997.
 - Retirement Plan enabling statutes.
 - State statutes, local ordinances.

Fiduciary Duties

Fiduciary duties fall into two broad categories – the duty of loyalty and the duty of care.

- The duty of loyalty requires trustees to act:
 - Solely in the best interests of the members, retirees, and beneficiaries of the retirement system
 - For the exclusive purpose of providing benefits
 - Impartially, avoiding conflicts of interest and self-dealing.

*Uniform Prudent Investor
Act 1994*

Fiduciary Duties

- The duty of care requires trustees to act:
 - With the care, skill, and prudence exercised by similar fiduciaries in investment-related matters, including diversification of investments.
 - To perform due diligence in matters related to investment of the system's assets.
 - To incur only costs that are appropriate and reasonable
 - To act in accordance with applicable statutes and regulations

Characteristics of Fiduciary Responsibility ⁶

Undivided Loyalty

Acting in a
Reasonable/Prudent
Manner

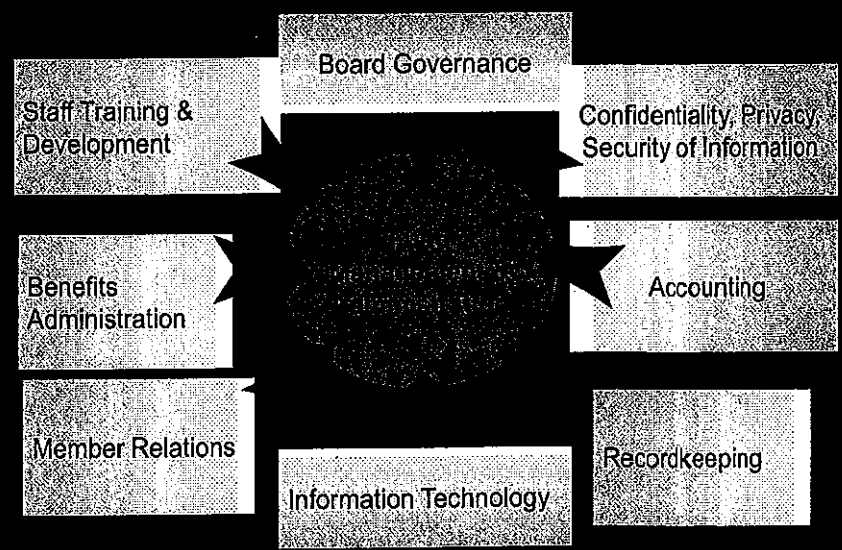
Avoiding Conflicts
of Interest

Protecting/Preserving
Plan Assets

Areas of Fiduciary Responsibility



Investment-Related Activities



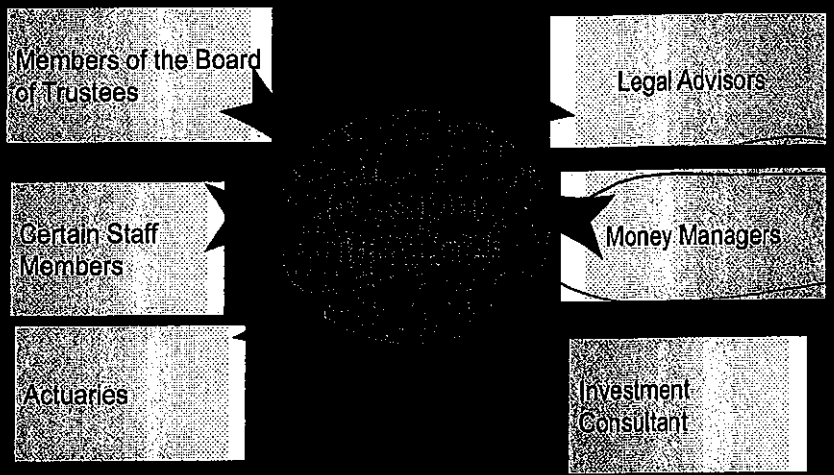
Communications & Education

- Handbooks & Pamphlets
- Periodic Newsletters
- Annual Report
- Annual Benefit Statements
- Annual Meeting
- Website
- Education Workshops
- Pre-Retirement Seminars

Investment-Related Activities

- Statement of Investment Policy and Objectives
- Selection of Investment Consultant
- Selection of Investment Managers
- Investment Management Agreements
- Monitoring of Investment Performance

Who Are Investment Fiduciaries?



Standard of Care for Investment-Related Activities

Changes to the Restatement of Trusts in 1992 and the UPIA resulted in a shift from the "prudent person" standard to the "prudent investor" standard, reflecting a recognition that, in accordance with Modern Portfolio Theory, prudence should be measured on an overall portfolio basis, rather than by consideration of specific investments.

Whether or not an investment-related decision is prudent is determined by the facts and circumstances when the decision is made, not based on the advantage of hindsight.

*measured by overall portfolio,
 ~ specific investments
 stan = "prudent investor" ↑*

Fiduciary Responsibility in Selecting Investment Managers

- Evaluation/Selection Process
- Due Diligence
- Investment Management Agreement
- Performance Monitoring

Evaluation/Selection Process

- An **investment consultant** may be retained to identify, screen, and recommend a number of investment managers to be interviewed by the Board.
- The **investment consultant** should be independent, and not have any undisclosed transactional fee or other business arrangement with any investment manager.
- An **investment committee** may be utilized in addition to or in lieu of an **investment consultant**. Members of the **investment committee** should disclose any personal, professional, or financial relationship they have or had with any investment manager under consideration for the investment allocation.

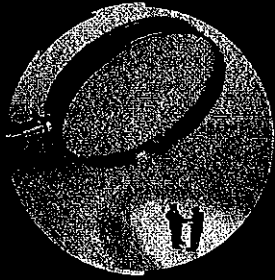
Evaluation/Selection Process

All relevant information regarding the investment should be provided to potential investment managers by the investment consultant or investment committee. Relevant information would include the Board's investment policy, the asset class, amount and method of allocation of funds, and other relevant information.

Evaluation/Selection Process

- The evaluation/selection process will often include a "blackout period," a specified period of time prior to final selection of the investment manager during which investment managers under consideration may not have contact with Board members or staff.
- Purpose of the blackout period is to preserve the integrity of the selection process and avoid the appearance of impropriety and/or undue influence.

Due Diligence



After a limited number of qualified investment managers have made presentations to the Board, the Board should conduct a thorough "due diligence" investigation before selecting the investment manager.

Monitoring Investment Manager Performance

Criteria for monitoring and evaluating Investment Manager performance should be clearly spelled out in the statement of Investment Policy and Objectives and/or in the Investment Management Agreement.

get Investment Management A-mat - sample from NAIPPA

Consultants & Advisors

Trustees and staff must exercise fiduciary responsibility in selecting the following consultants and advisors:

- Actuaries
- Auditors
- Custodian
- Outside Legal Counsel
- IT Consultants
- Medical Advisors

Problem Areas with Investment Managers and Consultants

- Indemnification language – Who is indemnifying who?
What is the trigger – negligence, gross negligence, willful and wanton misconduct, criminal conduct?
- Limitation of liability language – In the event of loss, Investment Managers or Consultants may attempt to limit their liability to the amount of the annual fee.

Breach of Fiduciary Duty

- In order to maintain a claim for breach of fiduciary duty, a plaintiff must establish the following:
 - Existence of a fiduciary relationship
 - Breach of the fiduciary duty
 - Causation
 - Harm (*i.e.* damages)
- A breach of fiduciary duty claim can be filed against individual trustees, as well as the Board itself.
- Vast difference in standards of care for negligence and breach of fiduciary duty claims.

Best Fiduciary Practices

- Thorough knowledge of your state's statutes and applicable local ordinances/regulations pertaining to fiduciary duties of your retirement system's trustees.
- Adopt Board Governance Policy, including Conflict of Interest guidelines
- Written statement of investment policy and objectives
- Annual financial and management audits
- Periodic review of administrative policies/procedures
- Criminal records check of prospective employees
- Establish trustee education program
- Staff education and training

Best Fiduciary Practices

- Ensure that accurate information is provided to retirees, spouses, and beneficiaries
- Adhere to your system's rules, regulations, policies, and procedures
- Establish administrative appeal procedure
- Exercise due diligence in selecting investment managers and professional consultants
- Monitor investment manager performance
- Conduct legal review of consultant and investment management agreements
- Consider Fiduciary Liability Insurance

Final Thoughts

The responsibilities of a fiduciary constitute the highest standard of duty imposed by law.

"Not honesty alone, but the punctilio of an honor the most sensitive, is the standard of behavior."

-- Chief Justice Benjamin Cardozo (1928)

For questions or comments, please contact:

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*Ok stat/re fiduciary
coverage*

NAPPA 2014 LEGAL EDUCATION CONFERENCE

New Attorney Session – Investments

June 24, 2014

Top 5 (ok, maybe 6) Issues to Consider in Investments

David Parrish, Jackson Walker L.L.P.

Patrick Kennedy, Ice Miller LLP

Michael Jordan, Ice Miller LLP



1. Sovereign Immunity

- Do you enjoy it?
- Because of state statute, investment policy or "investment policy"?
- If so, what does that mean for your investments and investment agreements?
- Governing law
- Venue and jurisdiction
- Jury trial waivers



2. Standard of Care

- Not unique to public pension plans but very relevant in light of Board and staff duties owed
- What standard should the GP or investment managers be held to?
- Language to be aware of in agreements
- Substantial negotiations and walk-aways



3. Public Records

- Unique analysis and approach that varies state-by-state
- "Top Level" information
- Concepts to avoid (trade secrets, resisting disclosure, cooperation with GP or investment manager)
- Remember "Open Meeting" aspects of this as well



4. Tax-Exempt Issues

- Are you (or should you be) UBTI-sensitive?
- Non-US investing
- State and local taxes
- Withholding issues and seeking refunds

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5. Ethics Matters

- Use of placement agents
- Payments or other compensation
- Gifts, meals and entertainment
- System internal policies
- Concerns with advising GPs or investment managers on these issues

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6. Headline Risk

- Public perception of alternative investments and the specter of "hedge funds"
- Offshore investments
- Broader issue than just investments

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LIGHTNING ROUND

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