

**FIDUCIARY RESPONSIBILITY AND LIABILITY
FOR PENNSYLVANIA
LOCAL GOVERNMENT EMPLOYEE
RETIREMENT SYSTEMS**

Public Employee Retirement Study Commission

February, 1989

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RETIREMENT SYSTEMS**

**PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION
COMMONWEALTH OF PENNSYLVANIA**

FEBRUARY, 1989

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COMMONWEALTH OF PENNSYLVANIA
PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION
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To Members of the Pennsylvania General
Assembly and Governor Casey:

Act 66 of 1981 directed the Public Employee Retirement Study Commission to study issues of public employee retirement, to formulate principles and objectives applicable to public employee retirement, and to recommend any new legislation deemed advisable. The Commission has identified the lack of a fiduciary responsibility and liability standard for the thousands of local government employee retirement systems in Pennsylvania as a significant deficiency, and this report contains the Commission's recommendations for remedying that deficiency.

The issue of fiduciary responsibility and liability was addressed for all private retirement plans in the Employee Retirement Income Security Act of 1974 (ERISA). Because ERISA does not apply to public retirement plans, fiduciary legislation is needed in Pennsylvania to establish a clear performance standard for all administrative aspects of local government retirement systems. The statewide retirement systems are not included in the proposed statute because the Commission believes adequate fiduciary standards already exist for those systems.

Properly designed fiduciary and liability standards for Pennsylvania's local government employee retirement systems will protect the taxpayers by increasing the probability that the retirement systems will be prudently run. Specific fiduciary standards will also protect active and retired public employees by requiring that their retirement systems be operated exclusively for the purpose of providing retirement benefits, by increasing the probability that the retirement systems will be able to pay their retirement benefits, and by making it clear whom to hold responsible in the event of problems. In addition, fiduciary standards will help public officials to know in advance what is acceptable behavior.

The first part of this report provides discussion and recommendations for each of the major elements of fiduciary responsibility and liability. The second part of the report is draft legislation implementing the Commission's recommendations for the General Assembly's consideration.

Pennsylvania's local government retirement systems have almost \$4 billion in assets, and the Commission believes that fiduciary responsibility and liability legislation is vital to the protection of those assets. Legislation to implement the Commission's recommendations on fiduciary standards for local government retirement systems will be introduced in the General Assembly in the near future. On behalf of the members of the Commission, I am soliciting your support for that legislation. I hope that the accompanying report will be of assistance to you in considering this important issue.

Sincerely,

A handwritten signature in cursive script that reads "Dale D. Stone".

Dale D. Stone
Chairman

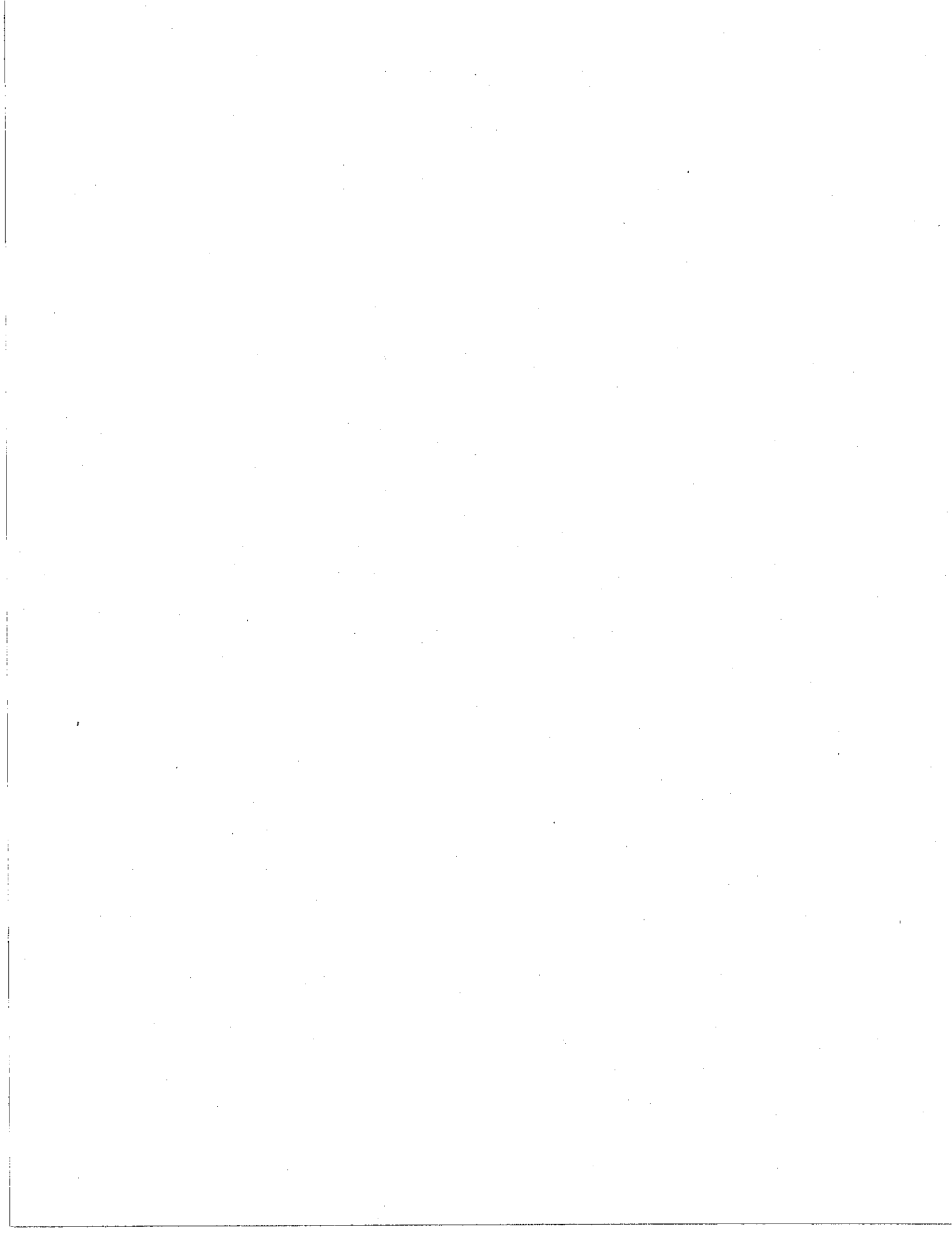


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INTRODUCTION

Pennsylvania has more public employee retirement systems than any other state in the nation - somewhere between one-fourth and one-third of all public pension plans in the country. Annual expenditures by Pennsylvania public employers for local government retirement systems are now approximately one-half billion dollars. Pennsylvania local government systems have almost \$4 billion in assets; yet this is only 60% of the assets needed to fully cover the actuarial accrued liabilities of these retirement systems. These facts evidence that the operation of public employee retirement systems in Pennsylvania is an important governmental function.

The revenue payers who ultimately must provide the money to pay for retirement benefits, the active and retired public employees who are looking to these retirement systems for their retirement security, and the elected and appointed public officials who must manage these systems, all have a vested interest in the proper operation of public employee retirement systems. Pennsylvania's problem is that the concerned parties lack a comprehensive standard for use in the conduct of local government employee retirement system administration. In the event of problems, revenue payers unexpectedly may have to pay much more, active and retired public employees may find their retirement benefits imperiled, or public officials may be subjected to "after the fact" judgements regarding their performance. Because of these potential consequences of inadequate fiduciary standards, the Public Employee Retirement Study Commission has determined that legislation to establish comprehensive, uniform standards for fiduciary activity in Pennsylvania's local government employee retirement systems is necessary to ensure the proper administration of this important governmental function. The Commission has studied the subject for over two years and now makes its report and recommendations to the Governor, the General Assembly, and the public.

The issue of fiduciary responsibility was addressed for all private retirement plans in the Employee Retirement Income Security Act of 1974 (ERISA). The legislation established standards and requirements for individuals who conduct the business of these private plans. Because ERISA does not apply to public retirement plans, the Commonwealth needs to define fiduciary relationships and standards for local governments. Fiduciary legislation is needed in Pennsylvania to establish, in one place, a clear standard for all administrative aspects of public employee retirement systems. Specifically designed local government employee retirement system fiduciary standards protect the revenue payers by increasing the probability that the retirement systems they are funding will be prudently run thus

preventing unexpected demands for additional revenues and by placing clear responsibility in the event of problems. Fiduciary standards also protect active and retired public employees by requiring that their retirement systems be operated exclusively for the purpose of providing retirement benefits, by increasing the probability that the retirement systems will be able to pay their retirement benefits, and by making it clear whom to hold responsible in the event of problems. In addition, fiduciary standards help public officials to know in advance what is to be done and what is acceptable behavior.

By statute, the Public Employee Retirement Study Commission is charged with studying and reporting on issues affecting public employee retirement systems in Pennsylvania. The Commission has identified the lack of an administrative standard for the thousands of local government employee retirement systems in Pennsylvania as one of these issues. Those who pay for, are paid by, and run public employee retirement systems need to know what they should do and what they should expect. The Commission's report explains the need for fiduciary standards, makes specific recommendations and contains proposed legislation implementing those recommendations.

I. GENERAL INFORMATION

Background

Under current law, a fiduciary is a person who has legal responsibility for the conservation and management of property in which another person has a beneficial interest. In early Anglo-American law, fiduciary responsibility primarily dealt with wills, estates, orphan's affairs, and private trusts. In the past several decades, with the growth of public and private sector retirement systems, efforts have been made to extend the concepts of fiduciary responsibility and consequent liability to some aspects of retirement system administration.

Fiduciary responsibility and liability standards and regulations for private sector retirement systems have been the outgrowth of several federal statutes. The most significant federal legislation covering fiduciary affairs for private sector retirement systems is the Employee Retirement Income Security Act of 1974 (ERISA). It applies to a broad class of retirement system officials, and requires (1) written trust instruments with named fiduciaries if authority is allocated or delegated to others, (2) operation of retirement systems solely in the interests of and for the exclusive purpose of providing benefits to plan participants and beneficiaries, (3) investment diversification, (4) a prudent expert standard of care and conduct, and (5) adherence to pension plan documents consistent with law. ERISA also increased civil remedies and liability for fiduciary breaches and limited investments in employer securities or with interested parties. Governmental or public employee retirement systems were excluded from the application of most of ERISA including the fiduciary responsibility and liability provisions. Congress has, however, since 1974, been considering legislation regulating public employee retirement systems following the example of ERISA.

In the absence of federal legislation, development of fiduciary responsibility and liability regulation in public sector retirement systems among the fifty states has been decentralized and varied in its extent and comprehensiveness. A number of public employee retirement systems in the fifty states have no explicit statutory fiduciary regulation and rely on the inventiveness and adaptability of the courts of the state when faced with an obvious fiduciary breach. Other public employee retirement systems simply utilize the law of that state governing the management of estates and trusts. The remaining public employee retirement systems have specific fiduciary regulations, but the regulation varies in comprehensiveness from a simple statement that a fiduciary relationship exists to an elaborate set of provisions designating the persons to whom the responsibility is applied, the standard of care or conduct by which they are to be judged, and additional specific limitations on discretion with respect to investments.

Current Status of Fiduciary Regulation of Pennsylvania Public Employee Retirement Systems

The subject of fiduciary responsibility and liability is not well addressed in Pennsylvania statutes governing local government employee retirement systems. The only developed fiduciary responsibility and liability legislation existing in Pennsylvania is applicable to the two statewide public employee retirement systems, the State Employees' Retirement Systems (SERS) and the Public School Employees' Retirement System (PSERS). The only applicable statutory regulation of fiduciary conduct for local government retirement systems in the Commonwealth is the Probate,

Estates and Fiduciaries Code, which is intended primarily to direct and limit the actions of persons managing decedent estates and orphans' trusts. The Probate, Estates and Fiduciaries Code was made applicable to most of the municipal retirement systems in 1982, primarily to broaden the investment authority of these retirement systems beyond a prior limit of governmental obligations.

Currently Pennsylvania law fails to define who has a fiduciary relationship with the retirement system and leaves a void with respect to the regulation of a potentially significant portion of fiduciary behavior and activity.

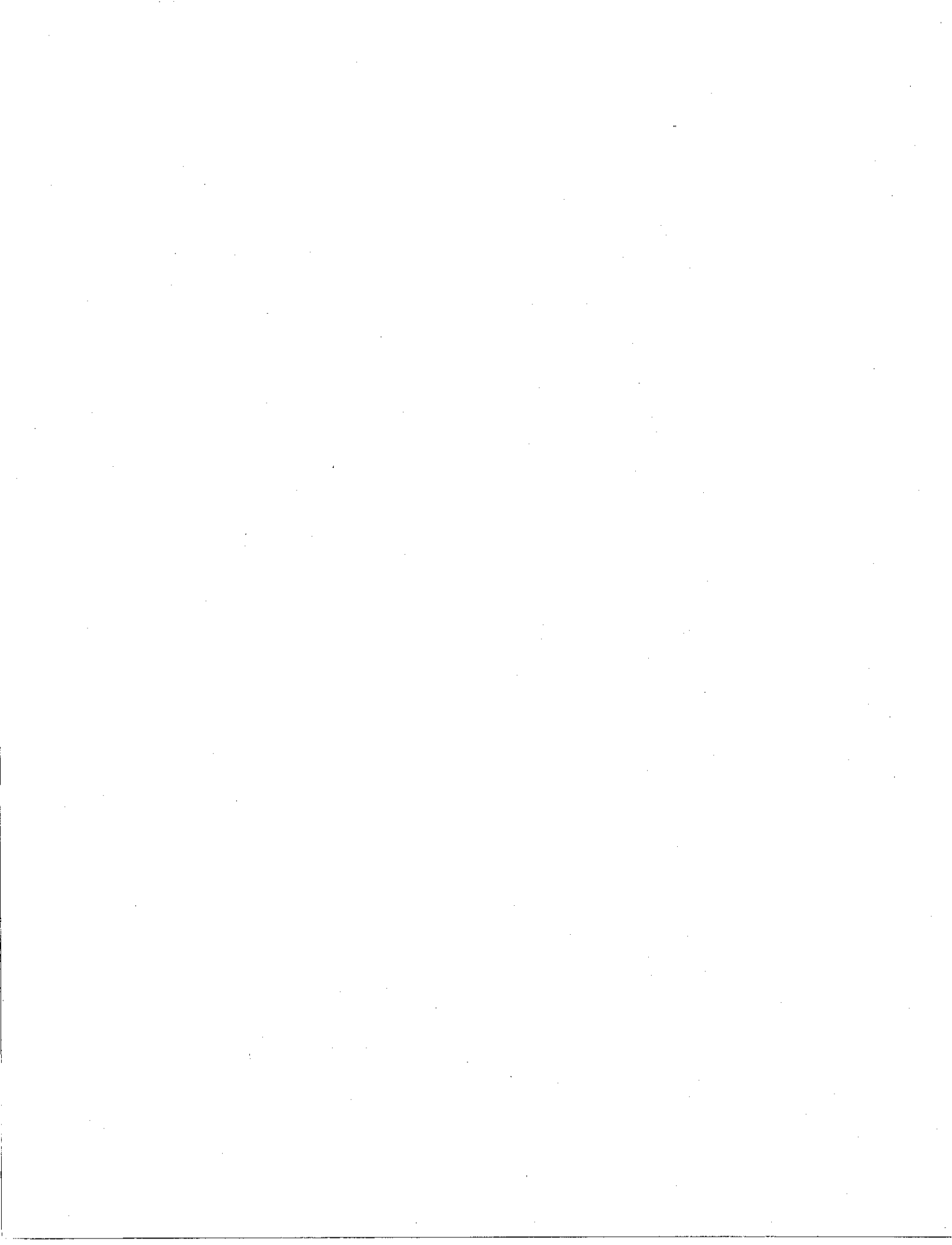
In order to address this void, the Commission recommends the adoption of legislation comprehensively regulating the fiduciary affairs of all Pennsylvania local government employee retirement systems. The statewide retirement systems are not included in the proposed statute because the Commission believes the proposal would needlessly complicate a carefully worked out system of fiduciary standards creating confusion and litigation without a commensurate benefit.

General Elements in Fiduciary Responsibility and Liability Regulation

The following chapters set forth and discuss the Commission's recommendations for legislation to regulate fiduciary responsibility and liability of local government employee pension plans. The recommendations address each of the major elements of fiduciary responsibility and liability. The elements of comprehensive regulation of fiduciary responsibility and liability are:

1. **Definition of Fiduciary** - Establishes the criteria for determining which persons connected with the retirement system have sufficient discretion in their actions to be held to a special standard of conduct in exercising that discretion.
2. **General Standard of Fiduciary Conduct** - Relates to the broad obligation that a fiduciary undertakes and broadly how the actions of that person in discharging that obligation will be judged in the event a legal question is raised.
3. **Specific Standards Supplementing the General Standard** - Specifies the additional constraints, limitations, or obligations of a fiduciary beyond the broad obligation imposed by the general standard of care or conduct.
4. **Liability for Fiduciary Breach** - Identifies the legal remedies applicable in the event that fiduciaries intentionally or negligently fail to meet the obligation of their fiduciary status.
5. **Responsibilities of Co-Fiduciaries** - Pertains to the obligations of one fiduciary for the actions of another fiduciary, the ability to delegate particular duties to another fiduciary without a residual obligation, and the liability of one fiduciary who knows of or permits a breach of fiduciary duty by another fiduciary.

6. **Fiduciary Insurance and Fiduciary Bonding** - Concerns the permissibility of buying insurance to cover losses resulting from a fiduciary breach and any obligation for fiduciaries to have a security or fidelity bond to protect the retirement system against loss by reason of fraud or dishonesty.



II. DEFINITION OF FIDUCIARY

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to the definition of fiduciary:

A. *That the basic definition of fiduciary be a person meeting one or more of the following criteria:*

1. *any person who exercises discretionary authority or control with respect to the management of a retirement system or exercises any authority or control with respect to its assets; or*
2. *any person employed directly by a system whose employment position includes the power to expend system money or approve the expenditure of money or the undertaking of a liability.*

B. *That the basic definition of fiduciary be augmented by the designation of specific individuals or employment positions that include the following:*

1. *any voting member of the governing body of the government or the system that has the power to approve modifications in the benefit plan of the retirement system;*
2. *any person rendering investment advice for a fee or other compensation, direct or indirect, with respect to any aspects of a retirement system;*
3. *any member of the managing board; and*
4. *the chief administrative officer of the system and any person who has actual or apparent authority to act on behalf of the chief administrative officer.*

C. *That a "named fiduciary" be designated for a retirement system.*

D. *That the following persons be excluded from the definition of fiduciary:*

1. *any person who is subject to fiduciary regulation under the Employee Retirement Income Security Act of 1974 with respect to a system providing benefit coverage to the applicable public employees;*

2. *any person without power to make any decisions as to retirement system policy, interpretations, practices, or procedures, or who does not have discretionary authority or control regarding management of assets and who does not render or have authority to render investment advice, but who performs purely ministerial activities.*

Discussion

The definition of a fiduciary closely parallels the definition of a fiduciary given in ERISA and does not expand upon the types of activities covered by such standards. A fiduciary is defined as (1) a person who exercises any discretionary authority or control over the plan's management or the disposition of its assets; (2) renders investment advice for a fee with respect to plan funds or assets; or (3) has any discretionary authority or responsibility in the plan's administration.

The basic definition is augmented by the designation of specific individuals or employment positions automatically deemed to be fiduciaries.

Every plan, except where a Commonwealth statute designates a fiduciary for a retirement system, is required to have a named fiduciary who shall have authority to operate the retirement systems.

Exclusions from the definition of fiduciary are limited to two groups. The first group consists of persons covered by ERISA fiduciary regulation. Excluding these persons avoids the possibility of double regulations in those cases where Pennsylvania public employees are covered by essentially private sector retirement systems (chiefly union-administered multi-employer retirement systems covering some municipal employees). The second group consists of persons performing purely ministerial activities. A listing of these activities, based on Department of Labor regulations, is provided in the proposed statute.

III. GENERAL STANDARD OF FIDUCIARY CONDUCT

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to the establishment of a general standard of fiduciary conduct:

- A. *That a general standard of fiduciary conduct that draws upon both the prudent person rule and the prudent expert rule be established.*
- B. *That the general standard of fiduciary conduct applicable to fiduciaries who do not have or are not required to have particular expertise be based on the prudent person rule and the general standard of fiduciary conduct applicable to fiduciaries who have or ought to have particular expertise be based on the prudent expert rule.*
- C. *That the general standard of conduct for fiduciaries who do not possess or are not required to have particular expertise be formulated as follows:*

Unless particular expertise or specialized knowledge is present or required, all fiduciary actions shall be undertaken in good faith with the exercise of that degree of judgment, skill, and care under the circumstances then prevailing that persons of prudence, sound discretion, and intelligence would exercise in the management of their own affairs. If the action involves or impacts on the investment of the assets of the public employee retirement system, it shall be undertaken not for speculation but for permanent investment considering the probable safety of the capital invested as well as the probable investment earnings to be derived therefrom.

- D. *That the general standard of conduct for fiduciaries who possess or are required to have particular expertise be formulated as follows:*

If particular expertise or specialized knowledge is present or required, all fiduciary actions shall be undertaken in good faith with the exercise of that degree of judgment, skill, and care under the circumstances then prevailing that persons of prudence, sound discretion, and intelligence who are acting in a like capacity and who are familiar with such matters would exercise in the conduct of an enterprise of a like character and with a like aim.

Discussion

The general standard of care or conduct establishes the criteria by which the actions of a fiduciary will be judged after some inappropriate action has been taken or inappropriate result has occurred. The general standard of conduct provides a broadly applicable statement of expectations for conduct to assist public employee retirement system fiduciaries in

understanding the responsibilities they have undertaken and provides a more easily imposed remedy in the event of a fiduciary breach.

The Commission recommends that the general standard of fiduciary conduct be drawn from both the prudent person rule and the prudent expert rule. These two rules are the most consistently well-evaluated general standards of fiduciary conduct among those historically utilized. The two-part general standard recommended by the Commission differentiates between the two rules on the basis of the presence or requirement of specialized knowledge. The differentiation allows application of the most appropriate standard to the specific factual situation in each case.

The prudent person rule has historically been the basic rule governing the investment of private trusts in this country. The following represent the basic elements of the prudent person rule:

- a. establishes a standard of care by which investment decisions will be judged;
- b. requires that the standard be applied to the specific factual situation as it was understood by the trustee at the time and not through hindsight;
- c. compares the actions of the trustee with that of a universal rational investor;
- d. requires knowledgeable and cautious investment, using the methods and techniques for investment then commonly understood;
- e. emphasizes a long term investment perspective and does not permit speculation; and
- f. emphasizes the joint aims of protecting the principal of the investment and maximizing the revenue derived from the investment, thus requiring a balancing of two potentially contradictory items.

In interpreting the rule, the courts have tended to emphasize the preservation of principal over the generation of investment revenue and have tended to focus on each individual investment separately rather than on the individual investment in the context of the entire portfolio.

The prudent expert rule, established by ERISA for private retirement systems, is a modification in the prudent person rule reflecting the growth of professional investment management and the need to better accommodate its actual practices and approaches. The key difference between the prudent expert rule and the prudent person rule is the basis for comparison of the actions of a fiduciary. The prudent person rule draws a comparison of the actions of a particular fiduciary with those that would have been taken by a universal rational investor. The prudent expert rule draws a comparison of the actions of a particular fiduciary with those that would have been taken by others acting in a like capacity in conducting an enterprise of like character with like aims, or, in other words, an investment expert. Missing from the ERISA prudent expert rule are the provisions of the prudent person rule disallowing speculation and

emphasizing maximization of investment return and maximization of investment capital safety. The ERISA prudent expert rule also moves the focus in the comparative standard of care from a consideration of specific investment securities individually to consideration of an entire investment portfolio and total portfolio objectives.

The Commission's recommendations restate the traditional prudent person and prudent expert rules with adaptations to cover both investment and administrative activities.



IV. SPECIFIC STANDARDS SUPPLEMENTING THE GENERAL STANDARD

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to the establishment of specific fiduciary conduct standards supplementing the general standard of fiduciary conduct:

- A. *That specific standards supplementing the general standard of fiduciary conduct be established.*
- B. *That the following broad range additional fiduciary conduct standards be applied to all fiduciaries:*
 1. *all system activities shall be carried out exclusively for the purposes of providing retirement benefits to system participants and beneficiaries and the payment of reasonable and necessary system administrative expenses with recognition of the obligation of the fiduciary as an official performing a governmental function to the governmental entity that established and maintains the system and to the revenue payers who are obligated to support the system; and*
 2. *all system activities shall be carried out in conformance with all applicable state and local laws.*
- C. *That the following narrow scope additional fiduciary conduct standards be applied to all fiduciaries with respect to their investment and asset management duties:*
 1. *each system by function of law or of separate instrument must establish a trust to be managed and controlled by the governing body, the managing board of the retirement system, or a separate board established for that purpose;*
 2. *title to all assets of a system, however constituted, must be held by the trust of the system in the name of the system, the governmental entity, or a nominee;*
 3. *any investment of the assets of the system must be diversified so as to minimize the risk of substantial investment losses unless the circumstances clearly indicate that it is not prudent to do so;*
 4. *no fiduciary shall personally profit either directly or indirectly beyond any reasonable compensation applicable to that position as a result of that person's fiduciary or system activities;*

5. *each fiduciary shall file with the chief administrative officer of the system a statement of that person's economic interests in sufficient detail to disclose any likely potential or actual conflicts of interest; and*
 6. *each system shall disclose through the issuance of a public document the recipients of any business placed or commissions allocated among any commercial banks, investment bankers, insurance companies, or brokerage organizations.*
- D. *That the following additional fiduciary conduct standards pertaining to investment and asset management activities be applied to fiduciaries who do not have or are not required to have particular expertise in performing their fiduciary functions:*
1. *any assets of a system that are invested shall be limited to the following specific types of investment securities:*
 - a. *U.S. Government Obligations. Bonds, notes, bills, mortgages and other fixed obligations issued and guaranteed by the United States, its agencies, or its instrumentalities;*
 - b. *Other Government Obligations. Bonds, notes, bills, mortgages and other fixed obligations issued by a state, municipality, special district, state agency, or state instrumentality, other than the entity sponsoring the pension plan, if the investment is made at the taxable-equivalent yields available in the marketplace at the time the investment is made, and if the obligation is backed by the full faith and credit of the state or applicable taxing jurisdiction or if the issuer has not been in default in the payment of principal or interest within the past ten years where the obligation is other than a revenue bond or if the obligor has been completely self-supporting for the immediate prior five-year period where the obligation is a revenue debt security;*
 - c. *Corporate Obligations. Bonds, notes, debentures, or other evidences of indebtedness issued by a corporation organized under the laws of the United States or of any state if the obligation has been rated among the top two quality categories by a nationally recognized rating agency;*
 - d. *Certificates of Deposit. Certificates of deposit issued by a bank or savings institution if rated in the highest quality category by a nationally recognized rating agency or meets any minimum collateral requirements applicable to banks or savings institutions authorized for the deposit of Commonwealth funds;*

- e. *Savings Accounts. Savings accounts in a bank or savings institution if fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation; and*
 - f. *Guaranteed investment contracts of insurance companies, and separate accounts of insurance companies and shares of investment companies that are limited to investing in the assets listed in a through e.*
2. *Such fiduciaries shall invest that portion of the assets of the system that equals the total potential benefit amounts payable in the succeeding year in authorized short term debt obligations that can be immediately liquidated without incurring any substantial determinable penalty or that have an average maturity of no more than thirty days.*
- E. *That the following narrow scope additional fiduciary standards pertaining to benefit plan coverage be applied to all fiduciaries:*
- 1. *Each system shall, unless its benefit plan is wholly contained in Commonwealth law, insure that all applicable relevant provisions of the benefit plan are compiled in one written document on file with the chief administrative officer of the retirement system and available to the general public; and*
 - 2. *Each system shall, unless its benefit plan is wholly contained in Commonwealth law, provide in the written instrument governing the benefit plan for an appeals procedure for benefit determinations that are adverse to the interests of the system participant or benefit recipient.*

Discussion

Specific fiduciary conduct standards beyond the general standard of fiduciary care provide either additional or alternative criteria for judging the conduct of a fiduciary. The establishment of specific additional standards can serve to reduce confusion over the general standard of fiduciary conduct, simplify the process of interpreting the fiduciary regulation, improve the remedy for potentially injured plan participants and benefit recipients, and provide fiduciaries clearer guidance for their future activities.

The Commission recommends the establishment of both broad range additional standards, those applicable to all major retirement system activity areas, and narrow scope additional standards, applicable to a specific area of retirement system activity. The specific areas for which narrow scope additional fiduciary conduct standards are recommended are the areas of investments and benefit plan coverage. The recommended additional standards largely parallel standards in effect under ERISA, with adaptations to reflect the public and governmental nature of the duties of a local government employee retirement system fiduciary.

The broad range additional fiduciary standards recommended by the Commission require that retirement system activities be carried out exclusively for the purpose of providing benefits to participants and beneficiaries and the payment of reasonable administrative expenses, while recognizing the obligation of public trust that the fiduciary owes to the sponsoring governmental entity and its revenue payers. The additional standards also require conformance with state and local laws in carrying out all retirement system activities.

In the area of investment and asset management, the Commission has recommended a set of standards applicable to all fiduciaries and an additional set of standards applicable to fiduciaries who do not have or are not required to have particular expertise in performing their fiduciary functions. The standards applicable to all local government employee retirement system fiduciaries include a requirement for formal establishment of a trust, a requirement that the trust hold title to all assets of the system, a requirement for diversification of investments, a prohibition against personal profit resulting from retirement system activities, a listing of permitted transactions and activities, a requirement for economic interest disclosure, and a requirement for disclosure of brokers and commissions. Special requirements applicable to fiduciaries who do not possess particular expertise in the performance of their fiduciary functions include a limitation on investments to a legal list of authorized types of investment securities and a minimum liquidity requirement. The establishment of special requirements for fiduciaries without investment expertise recognizes the highly decentralized nature of municipal retirement system administration in Pennsylvania and the lack of professional management in many of the systems. The requirements are intended to provide greater guidance to nonprofessionals in performing fiduciary functions and to limit the range of discretion to reduce the potential for imprudent action.

In the area of benefit plan coverage, the additional standards recommended by the Commission include a requirement that the benefit plan be compiled in a written document available to the public and a requirement that the plan include a procedure for appealing adverse benefit determinations.

V. LIABILITY FOR FIDUCIARY BREACH

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to liability to be imposed in the event of a fiduciary breach:

- A. *That any liability for a fiduciary breach reflect the degree to which the fiduciary breach is simply negligent or inadvertent or whether it is intentional and deliberate.*
- B. *That the following types of remedies be applicable to a fiduciary breach:*
 1. *actual, compensatory, or remedial liability or damages; and*
 2. *preventive remedies.*
- C. *That actual, compensatory, or remedial liability or damages be the personal liability of the fiduciary to restore the monetary losses incurred by the system, participant, or benefit recipient as a result of the breach or to pay to the system profits earned by or accruing to the fiduciary by virtue of the breach.*
- D. *That preventive remedies be:*
 1. *the removal of the person from the system position;*
 2. *an injunction requiring the fiduciary to perform or to refrain from performing one specified act or various specified acts associated with a fiduciary breach; or*
 3. *a mandamus order directing the performance of a specified fiduciary act or duty.*
- E. *That the applicable remedy for fiduciary breach that is the result of simple negligence or inadvertence be limited to actual, compensatory, or remedial damages.*
- F. *That the applicable remedy for a fiduciary breach that is the result of negligence beyond simple negligence or inadvertence but less severe than gross negligence be both the actual, compensatory, or remedial damages imposed above and the preventive remedies of an injunction or a mandamus order, if deemed appropriate.*
- G. *That the applicable remedy for a fiduciary breach that is the result of gross negligence or is willful or malicious be both the actual, compensatory, or remedial damages imposed above and the preventive remedy of removal of the person from the system position.*

Discussion

In determining the extent of liability to be imposed in the event of a fiduciary breach, the Commission's recommendations draw a distinction between a breach that is simply negligent or inadvertent and a breach that is willful or deliberate. The recommendations impose lesser or greater liability depending on the degree of the fiduciary breach. This distinction differs from fiduciary regulation under ERISA which does not explicitly differentiate between negligent breaches and deliberate breaches. Under ERISA the only potential for the imposition of liability that reflects differing degrees of fiduciary breach is through the broad grant of power provided to the federal courts to fashion whatever equitable or remedial relief, beyond restoration of losses, is deemed appropriate by the courts.

The Commission recommends that two types of liability be imposed, depending on the degree of the fiduciary breach. The following describes the two types of liability to be utilized in the event of a fiduciary breach and indicates the degree of breach under which each type of liability would be applicable.

1. **Actual, Compensatory or Remedial Damages.** This type of remedy is designed to eliminate a loss suffered by a retirement system, participant or benefit recipient due to a fiduciary breach or to restore profits gained by a fiduciary at the expense of the system. Where this type of liability is imposed, a fiduciary guilty of a breach is personally liable for restoring the loss or paying over the personal profits resulting from the breach. The Commission recommends that actual, compensatory or remedial damages be imposed in all cases of fiduciary breach. For a fiduciary breach resulting from simple negligence or inadvertence, actual compensatory or remedial damages would be the sole applicable remedy. For a fiduciary breach involving moderate negligence, gross negligence or willful misconduct, the remedy of actual, compensatory or remedial damages would be applied in conjunction with an appropriate preventive remedy.
2. **Preventive Remedies.** This type of remedy is intended to reduce or eliminate the potential for re-occurrences of fiduciary breaches. The preventive remedies utilized under the Commission's recommendations include an injunction ordering discontinuation of a practice associated with a fiduciary breach, a mandamus order directing the performance of a specified fiduciary duty, and removal of a person from the fiduciary position. Under the Commission's recommendations, the preventive remedy of injunction or mandamus may be utilized at the discretion of the court as an additional remedy beyond compensatory damages in a fiduciary breach involving moderate negligence. In the case of a fiduciary breach involving gross negligence or willful misconduct, the Commission recommends that the preventive remedy of removal from the fiduciary position be imposed in addition to the applicable compensatory damages.

VI. RESPONSIBILITIES OF CO-FIDUCIARIES

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to the responsibilities of co-fiduciaries:

- A. *That a co-fiduciary be liable for a breach by another fiduciary in the following circumstances:*
 1. *knowing participation in or knowing concealment of the activity that constitutes the breach;*
 2. *enablement of the breach through a failure to perform specific responsibilities that gave rise to fiduciary status;*
 3. *knowledge of the breach without undertaking reasonable efforts to remedy the breach;*
or
 4. *failure to observe the specified standard of fiduciary conduct in the delegation or allocation of fiduciary activities.*
- B. *That the liability imposed on a co-fiduciary be joint and several with the right of recovery on the part of the co-fiduciary against the breaching fiduciary.*
- C. *That both ministerial and discretionary activities be authorized to be delegated.*
- D. *That the delegation of ministerial activities be subject only to whatever procedural requirements the managing body of the system wishes to specify.*
- E. *That no transfer of liability accompany any delegation of ministerial activities with the delegating fiduciary remaining liable for the proper performance of the activity;*
- F. *That the delegation of discretionary activities be subject to minimum procedural requirements as follows:*
 1. *such activities may be delegated only to another fiduciary;*
 2. *any delegation of discretionary activities shall clearly specify the extent of, any conditions on, or any reservations pertaining to the delegation;*

3. *any delegation of discretionary activities shall be by mutual agreement of the fiduciaries involved;*
 4. *any delegation of discretionary activities shall not exceed the term of the fiduciary status of the person making the delegation;*
 5. *any delegation of discretionary activities shall terminate in the event that there is a material change in the circumstances applicable to the delegation; and*
 6. *any delegation of discretionary activities shall be contained in a document that shall be filed with the managing body of the system.*
- G. *That a transfer of liability accompany any delegation of discretionary activities unless the delegating fiduciary has knowledge of the breach combined with participation in, concealment of, or failure to take reasonable steps to remedy the breach.*
- H. *That particular scope fiduciary responsibilities be authorized to be allocated among fiduciaries, but that general scope fiduciary responsibilities not be subject to allocation among fiduciaries.*
- I. *That the following minimum procedural requirements apply to the allocation of fiduciary responsibilities:*
1. *the allocation of fiduciary responsibility shall be done in writing by action of the managing body of the system or by action of the applicable fiduciaries with notification to and approval by the managing body of the system; and*
 2. *the allocation of fiduciary responsibility shall be by agreement on the part of the affected fiduciaries.*
- J. *That a transfer of liability accompany any allocation of fiduciary responsibility unless the fiduciary who is to be relieved of liability by virtue of the allocation has knowledge of the fiduciary breach combined with participation in, concealment of, or failure to take reasonable steps to remedy the breach.*

Discussion

The various fiduciaries of a retirement system function in the capacity of co-fiduciaries and share in the responsibility of managing and operating the system. In most retirement systems, certain activities are the joint responsibility of all fiduciaries of the system, while some are delegated to agents, employees and functionaries and others are formally or informally allocated among the various fiduciaries. In order to effectively regulate the fiduciary affairs of local

government employee retirement systems, determinations must be made concerning the extent to which a fiduciary is responsible for and liable for the actions of other fiduciaries and whether any insulation from this co-fiduciary responsibility can occur through the use of delegation or allocation of fiduciary responsibilities.

Recognizing the joint nature of the duties and responsibilities undertaken by fiduciaries in a local government employee retirement system, the Commission recommends that co-fiduciary liability be imposed in four circumstances. The four circumstances giving rise to co-fiduciary liability are: (1) knowing participation in or knowing concealment of the breach; (2) enablement of the breach through failure to perform specific fiduciary responsibilities; (3) knowledge of the breach with failure to take reasonable action to remedy the breach; and (4) failure to observe the specified standard of fiduciary conduct in the delegation or allocation of fiduciary activity. Under this regulation, fiduciaries participating in, concealing, enabling or failing to remedy a breach by another fiduciary would participate or share in any liability that grew out of the fiduciary breach. In addition, co-fiduciary liability would exist in situations where no transfer of liability had taken place through proper delegation or allocation of the fiduciary activity constituting the breach. The liability imposed in the event of a breach involving co-fiduciary liability would be "joint and several" liability, under which each individual fiduciary is responsible for meeting the overall judgment and each fiduciary has the right of collection of the appropriate shares from all other responsible co-fiduciaries. The imposition of co-fiduciary liability reduces the potential for inadvertent fiduciary breaches and the opportunities for willful fiduciary breaches and assures that clear lines of fiduciary responsibility are maintained through the process of delegating or allocating fiduciary duties.

The Commission's recommendations specifically provide for a transfer of fiduciary liability through either the appropriate delegation of discretionary retirement system activity or the appropriate allocation of retirement system activities among fiduciaries. Provisions for regulating both the delegation process and the allocation process are included in the Commission's recommendations.

Among Pennsylvania's numerous and highly decentralized local government employee retirement systems, a number of persons holding fiduciary positions are involved with the local government employee retirement system on a part-time or intermittent basis. Consequently, a considerable portion of the retirement system activities are delegated to other public employees, contracted advisors, consultants and commercial enterprises. Delegation may involve "ministerial activities," those requiring no material exercise of discretion, or "discretionary activities," those requiring the exercise of a degree of independent judgment. The Commission's regulations specifically authorize the delegation of both ministerial and discretionary activities. In the case of the delegation of ministerial activities, the delegating fiduciary remains responsible for proper performance of the activity. With the delegation of discretionary activity, on the other hand, a transfer of liability accompanies the delegation. An exception to the transfer of liability would occur in cases where the delegating fiduciary participated in, concealed or failed to remedy the breach. The ability to delegate discretionary activities allows a local government employee retirement system to organize its affairs in the manner most appropriate to its needs. The procedure increases convenience in undertaking fiduciary duties on the part of the delegating fiduciary, accommodates the situation of part-time public officials or public officials with multiple municipal duties and recognizes the need for system officials to defer to available greater expertise. Because unstructured delegation can result in unclear lines of responsibility and a loss of accountability, the Commission

recommends regulation of the procedures by which the delegation of discretionary retirement system activities can occur. Included in the recommendations are requirements that delegation be made only to another fiduciary, that all conditions of a delegation be specified and that the delegation be agreeable to both parties. Additional administrative checks and balances are also specified. The procedural requirements insure that any delegation is understandable to the parties involved and is open to scrutiny by retirement system participants, benefit recipients, and other interested persons.

Another tool for organizing the affairs of a retirement system, in addition to delegation, is the allocation of fiduciary responsibility among the various fiduciaries of the system. Allocation allows fiduciaries to specialize in specific areas of retirement system activity and insulates other fiduciaries from liability in those areas. Under the Commission's recommendations, general scope responsibilities, those reflecting broad policy making powers and duties, are not subject to allocation and remain the joint responsibility of the applicable fiduciaries. Specific scope fiduciary responsibilities, those typically requiring a greater commitment of time, a higher degree of specialized knowledge and a greater consideration of detail, are authorized to be allocated subject to minimum procedural requirements. The Commission recommends that a transfer of liability accompany an allocation of fiduciary responsibility except in cases where the fiduciary who was to be relieved of liability under the allocation participated in, concealed or failed to remedy a breach. The ability to allocate fiduciary responsibility allows a retirement system to adapt to a complex, highly specialized environment and increases overall efficiency in the use of expertise available to the system. The minimum procedural requirements specified in the Commission's recommendations require that the allocation be done in a formal manner with agreement on the part of the affected fiduciaries. As with delegation, the minimum procedural requirements for allocation of fiduciary responsibility among fiduciaries insure that lines of responsibility and accountability remain clear and open to scrutiny.

VII. FIDUCIARY INSURANCE AND FIDUCIARY BONDING

Recommendations

The Public Employee Retirement Study Commission recommends the following with regard to fiduciary insurance and bonding:

- A. *That relief from liability for a fiduciary breach through an arrangement other than fiduciary insurance or bonding be prohibited in the case of fiduciaries who receive more than minimal compensation for their services.*
- B. *That systems be authorized to utilize an arrangement for their fiduciaries who receive no compensation or minimum compensation for their services that relieves these fiduciaries of responsibility for expenses incurred as a result of litigation with the exception of litigation brought by the governmental entity or the system arising from the failure of the fiduciary to perform that person's duties in accord with the applicable standards of fiduciary conduct.*
- C. *That the system or the governing body involved be authorized to expend the amount necessary to purchase reasonable amounts of fiduciary insurance.*
- D. *That all system fiduciaries directly involved in the investment and management of system assets, in the disbursement of money from the system, or in the formulation or approval of contracts on behalf of the system be covered by a bond provided by or underwritten by an insurer licensed to do business in the Commonwealth unless the specified alternative security arrangement exists.*
- E. *That the minimum amount of the bond be equal to the greater of \$2,000 or ten percent of the average annual amount of system assets managed, system disbursements made, or contract liability incurred, whichever is applicable to a maximum of \$500,000.*
- F. *That the following alternative security arrangements be acceptable in lieu of the fiduciary bonding requirement:*
 1. *a public official who is covered by a bond in that capacity and that person's fiduciary function is deemed to be within that official capacity under the terms of the bond; or*
 2. *an officer, director, or employee of a corporation, or a corporation, that:*

- a. *is organized and doing business under the laws of any state, the District of Columbia, or the United States;*
- b. *is authorized by the applicable law to exercise trust powers or to conduct an insurance business;*
- c. *is subject to applicable supervision or examination by a federal or a state governmental agency; and*
- d. *has on an ongoing basis a combination of contributed capital and retained earnings of at least \$1 million.*

G. That participation in the investment or management of any system assets, the disbursement of any money from the system, or the formulation or approval of any contracts on behalf of the system by a fiduciary not covered by the required fiduciary bond or the specified security arrangement be a misdemeanor of the third degree.

Discussion

A basic question in regulating fiduciary affairs is whether a fiduciary can be relieved in advance of liability resulting from fiduciary acts or omissions. In resolving this question, the Commission has drawn a distinction between fiduciaries receiving more than minimal compensation and fiduciaries who are uncompensated or minimally compensated. Under the Commission's recommendations, fiduciaries receiving more than minimum compensation for their services may not be relieved of liability through any arrangement other than fiduciary insurance or fiduciary bonding. Arrangements such as the use of an exculpatory clause in the retirement plan, indemnification of the fiduciary by the retirement system or a liability waiver clause in the pension plan are not permitted for these fiduciaries. In the case of uncompensated or minimally compensated fiduciaries, the Commission recommends that local government employee retirement systems be authorized to use an arrangement that relieves these fiduciaries of responsibility for expenses arising from litigation except in circumstances where the litigation is brought by the retirement system or governmental sponsor for failure to meet the applicable standards of fiduciary conduct. The prohibition against blanket advance relief from liability for fiduciary misdeeds is essential public policy in order to preserve the possibility of legal redress by those injured by a fiduciary breach and to retain the preventive and deterrent aspects of fiduciary regulation. On the other hand, where the service rendered by the fiduciary is essentially voluntary, some relief from liability is considered appropriate in order to remove the serious disincentive to public service that the threat of fiduciary liability represents. The relief from liability applicable to these uncompensated fiduciaries is structured so that knowledgeable misdeed or mismanagement remains subject to liability.

The Commission's recommendations identify fiduciary insurance as one of the two authorized means of providing protection from fiduciary liability. Since the passage of ERISA, the use of fiduciary insurance has become more common in private sector retirement systems. Fiduciary insurance is nothing more than an extension of error and

omission insurance to this specialized area of liability. Like any insurance, fiduciary insurance provides a means for persons who are exposed to a particular type of liability to pool their risk and share as a group in the financing of that liability rather than potentially suffering the full weight of liability individually. Fiduciary insurance increases the protection afforded to the retirement system, its participants, and its benefit recipients in the event of loss resulting from fiduciary activities and insulates the fiduciary personally from financial effects of liability for a loss resulting from fiduciary affairs in which the fiduciary participated. The ability to acquire fiduciary insurance facilitates the retention of existing fiduciaries and the recruitment of new fiduciaries, who may be unwilling to perform this public service if the liability potential is too great and no mechanism for insulating themselves from personal liability is available. The Commission's recommendations specifically authorize expenditures by either the retirement system or the local governmental sponsor for the purchase of reasonable amounts of fiduciary insurance. The authorization for a retirement system to acquire fiduciary insurance on behalf of its fiduciaries recognizes the protection from loss received by the system and its participants by virtue of the insurance.

The second means identified in the Commission's recommendations for providing protection from fiduciary liability is bonding. Bonding is a classic solution to the problem of insuring integrity and preventing fraud, loss, or theft on the part of a person provided with public trust. ERISA contains provisions requiring bonding by retirement system fiduciaries who handle system assets. The Commission recommends that local government employee retirement system fiduciaries involved in three areas of retirement system activities be required to be covered by a bond or an acceptable alternative security arrangement. The three activity areas for which bonding is required are investment and management of assets, disbursement of money and formulation or approval of contracts on behalf of the system. The Commission's recommendations specify the minimum amount of the fiduciary bond and set forth the alternative security arrangements that are acceptable in lieu of the bonding requirement. Alternative arrangements are considered acceptable in cases where adequate current protection against fraud and dishonesty exists, such as public officials bonded in sufficient amounts in their official positions and officers and employees of corporations with trust powers that are of sufficient size and subject to sufficient federal or state regulation to offer adequate protection.



DRAFT LEGISLATION

LOCAL GOVERNMENT

EMPLOYEE RETIREMENT SYSTEM FIDUCIARY ACT

AN ACT

Regulating the fiduciary affairs of local government employee retirement systems by providing for persons defined to be fiduciaries, fiduciary activities subject to regulation, general standards of fiduciary conduct, specific, supplemental fiduciary standards, liability for fiduciary breaches including breaches by other fiduciaries, delegation and allocation of fiduciary activities, fiduciary insurance and bonding; providing for penalties; and making repeals.

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The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

CHAPTER 1

GENERAL PROVISIONS

Section 101. Short title.-

This act shall be known and may be cited as the "Local Government Employee Retirement System Fiduciary Act."

Section 102. Findings of fact.-

The various statutory provisions that govern the wide variety of local government employee retirement systems in Pennsylvania do not adequately provide for fiduciary responsibility and fiduciary liability.

Section 103. Declaration of purpose.-

(a) Policy.-To protect the interest of members and beneficiaries in local government employee retirement systems and the interests of the Commonwealth and local governments and the general public in the operation of these retirement systems and to minimize the possible adverse impact of the operations of these retirement systems on government revenues and expenditures, it is hereby declared to be a public policy of the Commonwealth that the assets of a local government employee retirement system are pension trust funds and shall be held for the exclusive purposes of providing benefits to members in the retirement system and their beneficiaries and defraying reasonable expenses of administering the retirement system.

(b) Legislative intent.-It is the intent of the General Assembly to:

- (1) provide a statute comprehensively regulating the fiduciary affairs of all local government employee retirement systems;
- (2) encourage valuable service on management boards and advisory committees by qualified individuals who receive no compensation or minimum compensation for their services;
- (3) enable retirement systems to obtain the best possible investment, management, and other professional expertise; and
- (4) enable retirement systems to obtain bonds and fiduciary insurance at reasonable costs.

Section 104. Definitions.- The following words and phrases when used in this act shall have, unless the context clearly indicates otherwise, the meanings given to them in this section:

"ACTIVE MEMBER." A local government employee or officer, or a local government employee on leave without pay, for whom at any time during the retirement system year benefits are accrued under the pension plan on the individual's behalf, or for whom contributions are being made to a retirement system, or for whom the local government is obligated to contribute to the retirement system or under the pension plan on the individual's behalf, or for whom the local government would have been obligated to contribute to the retirement system or under the pension plan on the individual's behalf if any contributions were made to the retirement system or under the pension plan.

"ADEQUATE CONSIDERATION."

- (1) In the case of a security for which there is a generally recognized market, either:
 - (i) the price of the security prevailing on a national securities exchange that is registered under section 6 of Public Law 73-291, Title I, 48 Stat. 885, known as the Securities Exchange Act of 1934 (15 U.S.C. §78f), or
 - (ii) if the security is not traded on a national securities exchange that is registered under section 6 of Public Law 73-291, Title I, 48 Stat. 885, known as the Securities Exchange Act of 1934 (15 U.S.C. §78f), a price not less favorable to the retirement system than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of any party in interest; and

(2) In the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the managing board or named fiduciary under the terms of the pension plan.

"ASSETS." Probable future economic benefits obtained or controlled by a particular entity, such as a retirement system or a local government, as a result of past transactions or events. The word includes, but is not limited to, current assets such as cash and cash equivalents, short-term investments, receivables, inventories, and prepaid expenses; investment and funds such as long-term investments in securities, advances to other funds, long-term savings deposits, cash surrender value of life insurance policies, and long-term investments in tangible assets that are not used in current operations; tangible operational assets such as land, buildings, improvements other than buildings, machinery and equipment, and construction work in progress; intangible operational assets such as patents, copyrights, franchises, and trademarks; other assets such as long-term receivables from employees, and idle operational assets; and deferred charges such as machinery rearrangement costs, deferred income taxes, pension costs paid in advance, long-term prepaid insurance, and prepaid leasehold costs.

"BANK." A bank, banking and trust company, savings bank, trust company, or private bank, as defined in the act of November 30, 1965 (P.L. 847, No. 356), known as the Banking Code of 1965, or any savings and loan association, as defined in the act of December 14, 1967 (P.L. 746, No. 345), known as the Savings Association Code of 1967, or any successor statutes to these statutes, or any banking institution, trust company, or savings and loan association organized under the laws of the United States or of any state, or a receiver, conservator, or other liquidating agent of any of the foregoing.

"BENEFICIARY." A person designated by a member, or by the terms of a pension plan, who is or may become entitled to a benefit under the pension plan, or the estate or person who, as the result of the death of a member, qualifies for or is receiving some right or benefit under a pension plan.

"BUSINESS ENTITY." An association, business trust, corporation, group of two or more persons having a joint or common interest, partnership, trust, or other legal or commercial enterprise.

"CHIEF ADMINISTRATIVE OFFICER." The individual who has the primary responsibility for the execution of the administrative or management affairs of a local government in the case of a local government, or of the retirement system in the case of a retirement system, or the designee of that person.

"DISCRETIONARY ACTIVITY." A retirement system activity not required by law or pension plan or undertaken without the direction of a person in a superior position or of a superior rank or, if required or directed, the time, manner, or extent of execution of which is left to the person's prudence and judgment.

"EMPLOYEE ORGANIZATION." An organization of any kind, or any agency or employee representation committee or plan in which membership includes public employees, and that exists for the purpose, in whole or in part, of dealing with employers concerning grievances, employee-employer disputes, wages, rates of pay, hours of employment, or conditions of work; that has been certified as an exclusive bargaining representative of a bargaining unit of public employees under the act of July 23, 1970 (P.L. 563, No. 195), known as the Public Employee Relations Act, or the act of June 24, 1968 (P.L. 237, No. 111), relating to collective bargaining by police officers or firefighters, or both; and that does not practice discrimination in membership because of race, color, creed, national origin, political affiliation, or sex.

"EXERCISE OF DISCRETION." Acting or failing to act in accordance with the dictates of the person's own judgment or conscience uncontrolled by the judgement or conscience of another person in a superior position.

"FIDUCIARY." A person described in subchapter A of chapter 2.

"FUNCTION." When used in connection with a fiduciary, means any duty, obligation, power, authority, responsibility, right, privilege, activity, or program.

"GENERAL-SCOPE FIDUCIARY ACTIVITY." A retirement system activity that reflects broad or original policymaking powers and duties and that requires broad exercise of discretion by a fiduciary.

"GOVERNING BODY." The body or board of a local government designated to exercise the chief policymaking or legislative powers of the local government.

"INACTIVE MEMBER." A local government employee or officer, or former local government employee or officer, who is a former active member and for whom no contributions are being made but who has accumulated contributions standing to that individual's credit in the retirement system and who is not eligible to become or has not elected to become a vestee or has not filed an application for a retirement benefit.

"INVESTMENT ADVISER." A person registered as an investment adviser with the Securities and Exchange Commission under Public Law 76-768, Title II, 54 Stat. 847, known as the Investment Advisers Act of 1940 (15 U.S.C. §80b-1 et seq.); or a person registered as an investment adviser with the Pennsylvania Securities Commission under the act of December 5, 1972 (P.L. 1280, No. 284), known as the Pennsylvania Securities Act of 1972; who has acknowledged in writing that the person is a fiduciary of the retirement system.

"INVESTMENT MANAGER." A fiduciary (other than a member of a governing body, a member of a managing board, or a named fiduciary)

- (1) who has the power to manage, acquire, or dispose of any asset of a retirement system; or
- (2) who is an investment adviser, a bank, or an insurance company qualified to perform services described in paragraph (1) under the laws of a state; and
- (3) has acknowledged in writing that the person is a fiduciary of the retirement system.

"LOCAL GOVERNMENT." A local authority; a municipality, however constituted, whether operating under a legislative charter, municipal code, optional charter, home rule charter, optional plan, or other arrangement; an association of these local authorities, or these municipalities, or both cooperating under the act of July 12, 1972 (P.L. 762, No. 180), referred to as the Intergovernmental Cooperation Law; or a Commonwealth created authority or governmental entity whose employees are not members of the State Employees' Retirement System or the Public School Employees' Retirement System.

"LOCAL GOVERNMENT EMPLOYEE RETIREMENT SYSTEM." An entity, whether a separate entity or part of a local government entity, that collects retirement and other employee benefit contributions from local government employees and local governments; holds and manages the resulting assets as reserves for present and future retirement benefit payments; and makes provision for these payments to qualified retirees and beneficiaries. The phrase does not include a plan, program, or arrangement that is financed solely with local government employee earnings or compensation reported as local government employee earnings or compensation to the Internal Revenue Service,

United States Department of the Treasury, on Form W-2, Wage and Tax Statement, or established under sections 8.1 through 8.3 of the act of March 30, 1811 (P.L. 145, 5 Sm.L. 228), or established under section 408 of the Internal Revenue Code of 1986 (26 U.S.C. § 408).

“MANAGING BOARD.” Body or board of a retirement system that is appointed, assigned, or undertakes to jointly exercise the chief policymaking powers and management duties of the retirement system. If this body or board does not exist, the governing body.

“MEMBER.” An active member, inactive member, retiree, or vested.

“MINISTERIAL ACTIVITY.” A retirement system activity required by law or pension plan or undertaken at the direction of a person in a superior position or of a superior rank the execution of which is prescribed without regard to or the exercise of the person’s own judgment upon the propriety of the act being done.

“PARTICULAR-SCOPE FIDUCIARY ACTIVITY.” A retirement system activity that reflects limited or derivative policymaking powers and duties and that requires a narrow exercise of discretion by a fiduciary.

“PARTY IN INTEREST.”

- (1) Except as provided in paragraph (2):
 - (i) a fiduciary, counsel, or employee of a retirement system;
 - (ii) a person providing services to a retirement system;
 - (iii) a local government any of whose employees or officers are covered by the retirement system;
 - (iv) an employee organization any of whose members are covered by the retirement system;
 - (v) a relative of any individual described in subparagraphs (i) or (ii); or
 - (vi) an employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors), or a ten percent or more shareholder directly or indirectly, of:
 - (A) a person described in subparagraphs (ii), (iii), or (iv), or
 - (B) the retirement system.

(2) If any assets of a retirement system are invested in securities issued by an investment company registered under Public Law 76-768, Title I, 54 Stat. 789, known as the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), the investment shall not by itself cause the investment company or the investment company’s investment adviser or principal underwriter to be a party in interest except insofar as the investment company or its investment adviser or principal underwriter acts in connection with a retirement system covering employees of the investment company, the investment adviser or its principal underwriter. Nothing contained in this definition shall limit the duties imposed on an investment company, investment adviser, or principal underwriter by any other law.

“PLAN DOCUMENT.” The written document the managing board is required to compile and file under section 303.

“PENSION PLAN.” All aspects of an arrangement between a public employer and its employees concerning the retirement benefit coverage provided to the employees. The phrase does not include a plan, program, or arrangement that is financed solely with local government employee earnings or compensation reported as local government employee earnings or compensation to the Internal Revenue Service, United States Department of the Treasury, on Form W-2, Wage and Tax Statement, or established under sections 8.1 through 8.3 of the act of March 30, 1811 (P.L. 145, 5 Sm.L. 228), or established under section 408 of the Internal Revenue Code of 1986 (26 U.S.C. § 408).

"PENSION TRUST FUND." A fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities, and residual equities or balances, and changes therein, that is segregated for the purpose of accounting for assets held by a governmental unit in a trustee capacity for the members and beneficiaries of a public employee retirement system.

"RELATIVE." A spouse, brother, sister, spouse of a brother or sister, ancestor, lineal descendant, or spouse of a lineal descendant.

"RETIREE." A former local government employee or officer who is a former active member with vested rights in a retirement system on or after the effective date of retirement until that individual's retirement benefit is terminated.

"RETIREMENT BENEFIT." Annuity, pension, pension benefit, retirement pay, disability benefit, or other employee benefit payment from a retirement system.

"RETIREMENT SYSTEM." A local government employee retirement system.

"SECURITY."

(1) Any note; stock; treasury stock; bond; debenture; evidence of indebtedness; share of a beneficial interest in a business trust; certificate of interest or participation in any profit-sharing agreement; collateral trust certificate; preorganization certificate of subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; limited partnership interest; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease, or other mineral rights; or, in general, any interest or instrument commonly known as or having the incidents of a "security," including a "security" as defined in section 2(1) of Public Law 73-22, Title I, 48 Stat. 74, known as the Securities Act of 1933 (15 U.S.C. § 77b(1)), or as defined in section 102(t) of the act of December 5, 1972 (P.L. 1280, No. 284), known as the Pennsylvania Securities Act of 1972; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing. All of the foregoing are securities whether or not evidenced by written document.

(2) "SECURITY" does not include:

- (i) any beneficial interest in any voluntary inter vivos trust that is not created for the purpose of carrying on any business, or
- (ii) any beneficial interest in any testamentary trust, or
- (iii) any insurance or endowment policy or annuity contract under which an insurance company admitted in this Commonwealth promises to pay a sum of money (whether or not based upon the investment performance of a segregated fund) either in a lump sum or periodically for life or some other specified period, or
- (iv) any certificate issued under section 809 of the act of May 17, 1921 (P.L. 682), known as The Insurance Company Law of 1921.

"SEPARATE ACCOUNT." An account established or maintained by an insurance company under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such accounts without regard to other income, gains, or losses of the insurance company.

"VESTEE." A former local government employee or officer who is a former active member with vested rights in a retirement system who has terminated local government service and has elected to leave that individual's accumulated contributions in the retirement system and to defer receipt of a retirement benefit.

CHAPTER 2

SUBSTANTIVE PROVISIONS

SUBCHAPTER A

DESIGNATION OF AFFECTED FIDUCIARIES AND ACTIVITIES

Section 201. Fiduciary positions and functions. -

(a) Fiduciary. A person is a fiduciary of a retirement system:

(1) if the individual serves in one or more of the following positions:

(i) a member of the governing body when that governing body is exercising its authority, if any, to approve modifications in the pension plan of the retirement system;

(ii) a member of the managing board; or

(iii) the chief administrative officer of a retirement system or a person who has actual or apparent authority to act on behalf of the chief administrative officer;

(2) if the individual is an employee of a retirement system whose employment position includes the power to spend system assets, approve the expenditure of assets, or approve the incurring of a liability;

(3) a person designated a fiduciary under subchapter E of this chapter; or

(4) except as otherwise provided in subsections (b) and (c), if:

(i) the person exercises any discretionary authority or discretionary control with respect to management of a retirement system or exercises any authority or control with respect to its assets;

(ii) the person renders investment advice for a fee or other compensation, direct or indirect, with respect to any assets of a retirement system or has any authority or responsibility to do so; or

(iii) the person has any discretionary authority or discretionary responsibility in the administration of a retirement system.

(b) Certain investment companies not fiduciaries. If any asset of a retirement system is invested in securities issued by an investment company registered under Public Law 76-768, Title I, 54 Stat. 789, known as the the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), that investment shall not by itself cause the investment company or the investment company's investment adviser or principal underwriter to be deemed to be a fiduciary except insofar as the investment company or its investment adviser or principal underwriter acts in connection with a retirement system covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subsection shall limit the duties imposed on the investment company, investment adviser, or principal underwriter by any other law.

(c) Certain corporate personnel not fiduciaries. If the corporation assumes responsibility and liability for the actions taken or responsibilities assumed by its director, officer, or employee, no director, officer, or employee of a corporation that is itself a fiduciary shall be a fiduciary solely by reason of actions taken or responsibilities assumed in the course of that individual's employment or office with the corporation.

Section 202. Engaging in fiduciary activity.-

A person engages in a fiduciary activity if that activity is:

- (a) assigned to the person by law or pension plan;
- (b) undertaken by the person, even if the person by so doing is exceeding the person's actual or apparent authority;

or

- (c) an undertaking the person could reasonably be expected to undertake as a fiduciary.

Section 203. Named fiduciaries.-

Except when a statute of the Commonwealth designates a fiduciary for a retirement system, the governing body shall provide for the designation of one or more named fiduciaries, in a pension plan instrument or under a procedure specified in a pension plan instrument, who shall have authority to control and manage the operation and administration of the retirement system. This named fiduciary may be the governing body or the managing board.

Section 204. Persons excluded from definition of fiduciary.-

(a) Persons who have no power to make any decisions as to retirement system policy, interpretations, practices, or procedures, or who do not have discretionary authority or discretionary control respecting management of a retirement system, who do not exercise any authority or control respecting management or disposition of the assets of a retirement system, and who do not render investment advice with respect to any asset of the retirement system and have no authority or responsibility to do so, but who perform the following purely ministerial activities for a retirement system within a framework of policies, interpretations, rules, practices, and procedures made by other persons are not fiduciaries but may be subject to the bonding requirements under section 254:

- (1) application of rules to determine eligibility for membership or benefits;
- (2) calculation of service and compensation for benefit purposes;
- (3) preparation of employee communications material;
- (4) maintenance of members' service and employment records;
- (5) preparation of reports required by government agencies;
- (6) calculation of benefits;
- (7) orientation of new members and advising members of their rights and options under the pension plan;
- (8) collection of contributions and application of contributions as provided in the pension plan;
- (9) preparation of reports concerning members' benefits;
- (10) processing of claims; and
- (11) making recommendations to others for decisions with respect to retirement system administration.

(b) This statute applies to all persons except a person who is a fiduciary of a private retirement system that provides retirement benefit coverage to a local government employee and which is subject to fiduciary regulation under Public Law 93-406, Title I, 88 Stat. 829, known as the Employee Retirement Security Act of 1974 (29 U.S.C. ch. 18).

Section 205. Persons prohibited from being fiduciaries.-

(a) No person may be a fiduciary of a retirement system, engage in a fiduciary activity, or accept a position that is connected with a retirement system, including those of employee, consultant, manager, or advisor who:

- (1) has been removed from a fiduciary position for violating a provision of this statute for five years beginning on the day following removal from fiduciary position;

(2) has been removed from office under the act of August 14, 1963 (P.L. 1048, No. 452), relating to forfeiture of office of public officers convicted of certain crimes, for five years beginning on the day following removal from office; or

(3) has been convicted of one of the following criminal offenses for five years beginning on the day following conviction or, if the person convicted is then incarcerated, for five years beginning on the day following release from incarceration:

(i) a violation of Pennsylvania law that is murder of the first or second degree, a felony of the first, second, or third degree, or a misdemeanor of the first or second degree;

(ii) a violation of federal law specified in Section 411 of Public Law 93-406, Title I, 88 Stat. 829, known as the Employee Retirement Security Act of 1974 (29 U.S.C. § 1111); or

(iii) a violation of the law of another state, United States possession, federally recognized Indian tribal government, Chapter 4 of Title 10 of the United States Code (Uniform Code of Military Justice), law in effect in a foreign nation, or international law that would be a criminal offense listed in subparagraph (i).

(b) No business entity of which more than five percent of the equity or ownership interest is held by an individual who is prohibited from being a fiduciary under subsection (a) may provide consulting, management, or advisory service to a retirement system unless the business entity is a publicly held corporation.

SUBCHAPTER B GENERAL STANDARD OF FIDUCIARY CONDUCT

Section 211. To whom fiduciary duty is owed.-

A fiduciary, in performing a fiduciary activity or serving in a fiduciary position, owes a fiduciary duty to:

- (a) the members and beneficiaries;
- (b) the government that established the retirement system and its revenue payers; and
- (c) the Commonwealth and its revenue payers:

(1) if intergovernmental revenue from the Commonwealth is provided to a local government for its retirement system under the General Municipal Pension System State Aid Program or the Supplemental State Assistance Program, or both provided for in the act of December 18, 1984 (P.L. 1005, No. 1984-205), known as the Municipal Pension Plan Funding Standard and Recovery Act; or

(2) if the retirement system is required to file an actuarial valuation report with the Public Employee Retirement Study Commission under either the act of December 6, 1972 (P.L. 1383, No. 293), relating to actuarial valuation reporting by municipal pension systems, or the act of December 18, 1984 (P.L. 1005, No. 1984-205), known as the Municipal Pension Plan Funding Standard and Recovery Act.

Section 212. Fiduciary standards.-

- (a) Nonexpert (prudent person) standard.

A fiduciary who does not have, professes not to have, or cannot reasonably be expected to have special expertise in the fiduciary activity in which the fiduciary is engaged shall exercise that degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs and, if the fiduciary activity involves the investment of retirement system assets, as they would

act for the purpose of investment, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the the probable revenue to be derived from the assets as well as the probable safety of their capital.

(b) Expert (prudent expert) standard.

A fiduciary who has, professes to have, or can reasonably be expected to have special expertise in the fiduciary activity in which the fiduciary is engaged shall act in good faith and shall exercise that degree of judgment, prudence, skill, diligence, and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence acting in a similar capacity and familiar with that activity would exercise in the conduct of an enterprise of a similar character and with similar aims.

Section 213. Sole interest and exclusive purpose.-

To protect the interests of members and beneficiaries in a retirement system and the interests of the Commonwealth, or local government, or both and the general public in the operation of the retirement system and to minimize the possible adverse impact of the operation of the retirement system on government revenues and expenditures, a fiduciary shall discharge that fiduciary's duties with respect to a retirement system in accordance with the pension plan, the plan document, and law solely in the interest of the members and beneficiaries and for the exclusive purposes of:

- (a) providing benefits to members and beneficiaries; and
- (b) defraying reasonable expenses of administering the retirement system.

Section 214. Expert and nonexpert fiduciaries.-

(a) A governing body and its members, managing board and its members, chief administrative officer, local government employee, or retirement system employee making investments in accordance with investment advice from an investment adviser, making and managing investments in accordance with investment advice from and investment management by an investment manager, or administering a retirement system through a retirement system administrator with whom the local government or the retirement system has contracted under subchapter E of this chapter and section 304, 305, or 305 is an expert under section 212(b) only for investing and is otherwise a non expert under section 212(a).

(b) An investment adviser with whom the local government or retirement system has contracted under section 304, an investment manager with whom the local government or retirement system has contracted under section 305, or a retirement system administrator with whom the local government or retirement system has contracted under section 306 is an expert under section 212(b).

(c) Except as provided in subsection (a), a governing body member, managing board member, or chief administrative officer, as such, is a non expert under section 212(a), even if the individual is an accountant, actuary, attorney-at-law, banker, broker-dealer in securities, insurance agent, insurance broker, investment adviser, investment manager, retirement system administrator, etc. for another retirement system.

SUBCHAPTER C

SPECIFIC, SUPPLEMENTAL STANDARDS OF FIDUCIARY CONDUCT

Section 221. Retirement system trust.-

Unless the pension plan is contained entirely within law, the governing body of the local government of which the retirement system is a part, or the managing board, shall establish a trust to be managed and controlled by the governing body, the managing board, or a separate board established for that purpose.

Section 222. Title to retirement system assets.-

(a) Except as provided in subsection (b), all assets of a retirement system shall be held in trust for all persons with beneficial interests in these assets by the trustee. The trustee shall hold legal title to all assets of the retirement system, however constituted, in the name of the retirement system, the local government of which the retirement system is a part, or a nominee. The trustee shall be named in the trust instrument described in section 221, named in the plan document described in section 303, or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee shall have exclusive authority and discretion to manage and control the assets of the retirement system, except to the extent that:

(1) the pension plan expressly provides that the trustee is subject to the direction of a named fiduciary who is not a trustee, in which case the trustee shall be subject to proper directions of the named fiduciary that are made in accordance with the terms of the pension plan and that are not contrary to this statute, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated to an investment manager under section 305 or retirement system administrator under section 306.

(b) The requirements of subsection (a) do not apply to the assets of:

(1) a retirement system that consist of insurance contracts or policies issued by an insurance company qualified to do business in the Commonwealth; or

(2) of an insurance company or any assets of a retirement system that are held by an insurance company.

Section 223. Diversifying investments.-

Fiduciaries shall diversify the investments of the retirement system so as to minimize the risk of large losses and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

Section 224. Prohibited transactions by retirement systems.-

A fiduciary shall not cause a retirement system to engage in a transaction if the fiduciary knows or should know that the transaction constitutes a direct or indirect:

(a) sale, or exchange, or leasing, of any asset from the retirement system to a party in interest for less than adequate consideration, or from a party in interest to a retirement system for more than adequate consideration;

(b) lending of money or other extension of credit from the retirement system to a party in interest without the receipt of adequate security and a rate of interest that is consistent with the requirements relating to fiduciary functions under sections 211, 212, and 213, or from a party in interest to a retirement system with the provision of excessive security or a rate of interest that is inconsistent with the requirements relating to fiduciary functions under sections 211, 212, and 213;

(c) furnishing of goods, services, or facilities from the retirement system to a party in interest for less than adequate consideration, or from a party in interest to a retirement system for more than adequate consideration;

(d) transfer to, or use by, or for the benefit of, a party in interest of any assets of the retirement system for less than adequate consideration;

(e) except as provided in sections 227 and 263, acquisition, on behalf of the retirement system, of any security, real property, or loan of the local government of which the retirement system is a part or any of whose employees or officers are covered by the retirement system.

Section 225. Prohibited activities by fiduciary.-

A fiduciary shall not:

(a) deal with the assets of the retirement system in that fiduciary's own interest or for that fiduciary's own account;

(b) in that fiduciary's individual or in another capacity, act in a transaction involving the retirement system on behalf of a party, or represent a party, whose interests are adverse to the interests of the retirement system or the interests of its members and beneficiaries; or

(c) receive consideration for that fiduciary's personal account from a party dealing with the retirement system in connection with a transaction involving the assets of the retirement system.

Section 226. Certain transactions and activities permitted.-

Nothing in sections 224 or 225 shall be construed to prohibit:

(a) Contracting or making reasonable arrangements with a party in interest for office space, or accounting, actuarial, legal, or other services necessary for the establishment or operation of the retirement system, if no more than reasonable compensation is paid therefor.

(b) The investment of all or part of a retirement system's assets in deposits that bear an interest rate that is consistent with the fiduciary duties under sections 211, 212, and 213, in a bank or similar institution supervised by the United States or a state, if the bank or other institution is a fiduciary of the retirement system and if the investment is expressly authorized by a provision of the pension plan or by a fiduciary, other than the bank or other institution or an affiliate thereof, who is expressly empowered by the pension plan to authorize the investment.

(c) The providing of any ancillary service by a bank or similar financial institution supervised by the United States or a state, if the bank or other institution is a fiduciary of the retirement system, and if:

(1) the bank or other institution has adopted adequate internal safeguards that assure that the providing of the ancillary service is consistent with sound banking and financial practice, as determined by federal or state supervisory authority, and

(2) the extent to which the ancillary service is provided is subject to specific guidelines issued by the bank or similar financial institution, as approved by federal or state supervisory authority, and adherence to these guidelines would reasonably preclude the bank or other institution from providing the ancillary services

(i) in an excessive or unreasonable manner, and

(ii) in a manner that would be inconsistent with the best interests of members and beneficiaries of the retirement system.

These ancillary services shall not be provided at more than reasonable compensation.

(d) Any transaction between a retirement system and a common or collective trust fund or pooled investment fund maintained by a party in interest that is a bank supervised by a state or federal agency or a pooled investment fund of an insurance company qualified to do business in the Commonwealth, if:

- (1) the transaction is a sale or purchase of an interest in the fund,
- (2) the bank or insurance company receives not more than reasonable compensation, and
- (3) the transaction is expressly permitted by the pension plan under which the retirement system is maintained, or by a fiduciary, other than the bank or insurance company, or an affiliate thereof, who has authority to manage and control the assets of the retirement system.

(e) A fiduciary or party in interest from receiving any benefit to which the fiduciary or party in interest may be entitled as a member or beneficiary of the retirement system, or paying any benefit to any member or beneficiary, so long as the benefit is computed and paid on the basis that is consistent with the terms of the pension plan as generally applied to all members and beneficiaries.

(f) A fiduciary or party in interest from receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of the functions of the fiduciary or party in interest with respect to the retirement system, except that no individual so serving who already receives full-time pay from a local government whose officers or employees are members in the retirement system or an employee organization whose members are members in the retirement system, shall receive compensation from the retirement system, except for reimbursements of expenses properly and actually incurred.

(g) A fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

(h) A merger of retirement systems or the aggregation of public employee pension trust funds under section 607(b) of the act of December 18, 1984 (P.L. 1005, No. 1984-205), known as the Municipal Pension Plan Funding Standard and Recovery Act.

(i) A return of a contribution that was made by a mistake of fact or law within one year after the chief administrative officer determines that the contribution was made by such a mistake.

Section 227. Certain interfund transactions.-

- (a) Interfund receivables and advances to other funds.

A fiduciary shall not cause a public employee pension trust fund to engage in a transaction if the fiduciary knows or should know that the transaction constitutes a direct or indirect loan of the retirement system assets to another fund of the local government.

- (b) Due from and due to other funds.

Nothing in subsection (a) shall prevent a public employee pension trust fund from purchasing goods or services in a quasi-external transaction from another fund of the local government for adequate consideration, or another fund of the local government making routine employer contributions to the public employee pension trust fund in a quasi-external transaction, provided the amount due from or to the public employee pension trust fund for the goods, services, or contributions is paid on the normal fiscal cycle payment date for such transactions (at the end of the week, month, quarter, etc.) or sooner, and further provided that the amount due is paid within one year.

(c) Interfund reimbursements.

Nothing in subsection (a) shall prevent a public employee pension trust from reimbursing another fund of the local government or another fund of the local government from reimbursing the public employee pension trust fund for expenditures or expenses initially made from the one fund but that properly apply to the other fund or clearing-account payments made for expediency in a controlled environment, provided the reimbursement from or to the public employee pension trust fund is made on the normal fiscal cycle payment date for such transactions (at the end of the week, month, quarter, etc.) or sooner, and further provided that the reimbursement is made within one year.

Section 228. Statement of financing interest.-

A fiduciary shall file a statement of financial interest as through the fiduciary were a public employee or public official required to file a statement of financial interest under the act of October 4, 1978 (P.L. 883, No. 170), relating to conflicts of interest and financial disclosures by public officials and public employees. A fiduciary who has filed this statement of financial interest as a public employee or public official of the retirement system does not have to file another statement.

Section 229. Prohibitions in procuring bonds and insurance.-

A person shall not procure any bond required by section 254(a) or any insurance permitted by section 255 from any surety, insurance company, or other company or through any agent or broker in whose business operations the retirement system or any party in interest in the retirement system has any control or significant financial interest, direct or indirect.

**SUBCHAPTER D
NONEXPERT FIDUCIARIES INVESTMENTS**

Section 231. Authorized investments by nonexpert fiduciaries in general.-

A fiduciary who does not have, professes not to have, or cannot reasonably be expected to have special expertise in the fiduciary activity in which the fiduciary is engaged, subject only to the provisions of the pension plan and plan document, if any, may accept, hold, invest in, and retain the investments authorized by this subchapter and shall not be liable for loss on these investments so long as the fiduciary exercises the due care and prudence required by this statute in the performance of that fiduciary's duties in regard to them. "Legal investment" or "authorized investment" or words of similar import used in the pension plan or the plan document shall be construed to mean an investment authorized by this subchapter.

Section 232. Liquidity.-

A fiduciary investing under section 231 shall invest that portion of the assets of the retirement system that equals the total potential benefit amounts payable in the succeeding year in authorized short term debt obligations that can be immediately liquidated without incurring any substantial, determinable penalty or that have an average maturity of no more than thirty days.

Section 233. United States Government obligations.-

Bills, notes, bonds, mortgages, and other fixed obligations issued and guaranteed by the United States, its agencies, or its instrumentalities shall be authorized investments.

Section 234. Other government obligations.-

Except for the obligations of the local government that created the retirement system or of which the retirement system is a part, bonds, notes, bills, mortgages, and other fixed obligations issued by a state, municipality, special district, state agency, or state instrumentality shall be authorized investments, if the investment is made at the taxable-equivalent yields available in the marketplace at the time the investment is made, and:

- (a) if the obligation is backed by the full faith and credit of the state of applicable taxing jurisdiction;
- (b) if the obligation is other than a revenue bond and if the issuer has not been in default in the payment of principal and interest within the past ten years; or
- (c) if the obligation is a revenue debt security and if the obligor has been completely self-supporting for the immediate prior five year period.

Section 235. Corporate obligations.-

Bonds, notes, debentures, or other evidences of indebtedness issued by a corporation organized under the laws of the United States or of any state, if the obligation has been rated among the top two quality categories by a nationally recognized rating agency shall be authorized investments.

Section 236. Certificates of deposit.-

Certificates of deposit issued by a bank if rated in the highest quality category by a nationally recognized rating agency or meets the minimum collateral requirements applicable to banks authorized for the deposit of Commonwealth funds shall be authorized investments.

Section 237. Savings accounts.-

Savings accounts in a bank if fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation shall be authorized investments.

Section 238. Insurance products.-

(a) Contracts that provide a guarantee of principal and a fixed rate of return issued by an insurance company that has qualified and is authorized by the Insurance Department of the Commonwealth to transact business in the Commonwealth shall be authorized investments.

(b) Separate accounts of an insurance company that has qualified and is authorized by the Insurance Department of the Commonwealth to transact business in the Commonwealth shall be authorized investment provided that the only investments of these separate accounts are in the authorized investments for retirement systems listed in sections 233 through 237. This subsection shall not limit the authority of nonexpert fiduciaries to provide for the investment of retirement system assets in other separate accounts of insurance companies using the advice of an investment advisor or investment manager under section 304 or 305.

Section 239. Shares of an investment company.-

Shares of an investment company registered under Public Law 76-768, Title I, 54 Stat. 789, known as the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), whole shares are registered under Public Law 73-22, Title I, 48 Stat. 74, known as the Securities Act of 1933 (15 U.S.C. § 77a et seq.), shall be authorized investments provided that the only investments of that company are in the authorized investments for retirement systems listed in sections 233 through 237.

SUBCHAPTER E

DELEGATION AND ALLOCATION OF FIDUCIARY ACTIVITIES

Section 241. Co-fiduciary responsibility in general.-

A fiduciary has a general responsibility to oversee the fiduciary activities of all other fiduciaries unless the activity has been allocated in accordance with section 244 or delegated in accordance with section 245. A fiduciary also has a general responsibility to correct or remedy fiduciary breach of which the fiduciary has knowledge.

Section 242. Liability for breach of fiduciary duty by another fiduciary.-

A fiduciary is liable for a fiduciary breach committed by another fiduciary when the fiduciary has a responsibility to oversee the other fiduciary or to correct or alleviate a breach by the other fiduciary. In the following circumstances, in addition to the liability that the fiduciary may have under another provision of this statute, a fiduciary is jointly and severally liable for a breach of fiduciary duty by another fiduciary of the same retirement system, but the fiduciary has the right to recover the compensatory damages the fiduciary paid from the responsible fiduciary:

- (a) if the fiduciary allocates a fiduciary activity contrary to section 244;
- (b) if the fiduciary delegates a fiduciary activity contrary to section 245;
- (c) if, by the fiduciary's failure to comply with this statute, the fiduciary enables the other fiduciary to commit a breach;
- (d) if the fiduciary knowingly participates in or knowingly undertakes to conceal an act or omission by the other fiduciary knowing that act or omission is a breach; or
- (e) if the fiduciary has knowledge of a breach by the other fiduciary, unless the fiduciary makes reasonable efforts under the circumstances to remedy the breach.

Section 243. Limitation on responsibility and liability for fiduciary breach by another fiduciary.-

- (a) A fiduciary may limit that fiduciary's responsibility and liability for a fiduciary breach committed by another fiduciary through the allocation or delegation of fiduciary activities if:
 - (1) the allocation or delegation:
 - (i) follows appropriate procedures,
 - (ii) is made to an appropriate person or persons, and
 - (iii) is subject to continued monitoring of performance; and
 - (2) the fiduciary does not violate section 242.
- (b) Particular-scope fiduciary activities may be allocated.
- (c) General-scope fiduciary activities may not be allocated.
- (d) Ministerial activities may be delegated.
- (e) Discretionary activities may be delegated.

Section 244. Allocation of fiduciary activities.-

Fiduciaries of similar rank and responsibility may allocate a particular-scope fiduciary activity:

- (a) in writing, by action of the managing board, governing body of the government of which the retirement system is a part, or the appropriate fiduciaries with notification to and approval by the managing board;
- (b) with the agreement of the affected fiduciaries; and
- (c) in conformance with any additional procedural requirements specified by the managing board.

Section 245. Delegation of fiduciary activities.-

(a) A fiduciary may delegate a ministerial activity, but not fiduciary liability for that ministerial activity, to another fiduciary of lesser rank or responsibility or to a person who, but for the delegation, would not be a fiduciary. The fiduciary shall make this delegation in accordance with procedures established by the managing board.

(b) A fiduciary may delegate a discretionary activity and, except in the circumstances listed in section 242, fiduciary liability for that discretionary activity to another person:

- (1) if the extent of the delegation and the conditions or limitations on the delegation are clearly specified;
- (2) with the agreement of the person to whom the activity is delegated;
- (3) for a specified time that may not exceed the term or the remaining period of fiduciary status of the person making the delegation;
- (4) subject to termination in the event of a material change in the circumstances applicable to the delegation;
- (5) with the filing of a written summary of the delegation with the managing board; and
- (6) in conformance with the additional procedural requirements specified by the managing board.

SUBCHAPTER F

FIDUCIARY BONDING AND FIDUCIARY INSURANCE

Section 251. General prohibition of indemnification.-

A fiduciary shall be exculpated, indemnified, or otherwise relieved of liability for a fiduciary breach only by a bond, fiduciary insurance, or as provided either in section 252 or under subchapter C, relating to actions against local parties, of chapter 85, relating to matters affecting government units, of Title 42 of the Consolidated Pennsylvania Statutes. An arrangement or plan document provision providing other exculpation, indemnification, or relief from liability for a fiduciary breach is prohibited as a practice contrary to public policy.

Section 252. Indemnified fiduciaries.-

The governing body or managing board may indemnify from liability for an unintentional fiduciary breach a fiduciary who receives no compensation or compensation of not more than \$600 a year for that fiduciary's services.

Section 253. Required indemnification.-

An indemnified fiduciary of a retirement system shall be held harmless from reasonable costs or expenses incurred as a result of actual or threatened litigation or other proceedings arising from the good faith performance of fiduciary duties, except for litigation or other proceedings brought by the local government of which the retirement system is a part or by the retirement system arising from the failure of the fiduciary to act in accordance with this statute.

Section 254. Bonding and alternative security arrangements.-

(a) Bonding.

(1) Every fiduciary and every person who handles assets of retirement system (hereinafter in this section referred to as a "system official") shall be bonded as provided in this subsection, except as provided in subsection (b).

(2) The amount of the bond shall be fixed by the governing body or managing board at the beginning of each retirement system year. The minimum amount of this bond shall be the greater of ten percent of the assets handled or \$2,000. The maximum amount of this bond need not exceed \$500,000. The governing body or managing board may require the minimum amount, or the maximum amount, or both, of the bond to be a larger amount.

(3) For purposes of fixing the amount of the bond, the amount of assets handled shall be determined by the assets handled by the person, group, or class to be covered by the bond and by their predecessor or predecessors, if any, during the preceding retirement system year, or if the retirement system has no preceding year, the amount of assets anticipated to be handled during the current retirement system year by this person, group, or class.

(4) The bond shall provide protection to the retirement system against loss by reason of acts of fraud or dishonesty on the part of the system official, directly or through connivance with others.

(b) Alternative arrangements in lieu of bonding. The following alternative arrangements are acceptable in lieu of the bond required by subsection (a):

(1) a public official who is covered by a bond in that official's capacity as a public official and whose fiduciary function is within that official capacity under the terms of that bond; or

(2) an officer, director, or employee of a corporation, or a corporation, that:

(i) is organized and doing business under the laws of a state or the United States;

(ii) is authorized by the applicable law to exercise trust powers or to conduct an insurance business;

(iii) is subject to applicable supervision or examination by a federal or a state governmental agency; and

(iv) has, on an ongoing basis, a combination of contributed capital and retained earnings of at least one million dollars; or

(3) if the retirement system is one under which the only assets from which benefits are paid are the general assets of an employee organization.

(c) Purchase of bonds authorized. A governing body or managing board is authorized to spend the amount necessary to purchase the bond required by subsection (a).

Section 255. Insurance.-

(a) Retirement system insurance. A governing body or managing board may purchase insurance for its retirement system to cover the liability or loss resulting from a fiduciary act or omission. This insurance must be obtained from an insurance company authorized to do business in this Commonwealth or, if established and functioning, a government established fiduciary insurance pool or similar mechanism. This insurance must permit recourse by the insurer against the fiduciary in the case of an intentional breach of a fiduciary obligation by the fiduciary.

(b) Individual fiduciary insurance.

(1) A governing body or managing board may buy insurance for its fiduciary who receives no compensation or compensation of not more than \$600 a year for that fiduciary's services to cover liability or loss incurred individually by the fiduciary by reason of fiduciary acts or omissions. This insurance must permit recourse by the insurer against a fiduciary who is responsible for an intentional fiduciary breach.

(2) A fiduciary or an employee organization may buy fiduciary insurance to cover liability or loss incurred individually by a fiduciary by reason of a fiduciary act or omission.

(3) The governing body, managing board, fiduciary, or employee organization buying insurance under this subsection shall buy it from an insurance company authorized to do business in this Commonwealth.

(c) A governing body or managing board is authorized to spend the amount necessary to buy reasonable amounts of fiduciary insurance under subsections (a) and (b).

SUBCHAPTER G

SPECIAL ASSET RULES

Section 261. Investment company security.-

When a retirement system invests in a security issued by an investment company registered under Public Law 76-768, Title I, 54 Stat. 789, known as the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), the assets of the retirement system include the security but do not, solely by reason of the investment, include any assets of the investment company.

Section 262. Insurance contract or policy.-

When a retirement system is financed in whole or in part by a contract, or policy of insurance, issued by an insurance company that is qualified and is authorized by the Insurance Department of the Commonwealth to transact business in the Commonwealth, the assets of the retirement system include the contract or policy but do not, solely by reason of the issuance of the contract or policy, include the assets of the insurance company issuing the contract or policy except to the extent that the assets are maintained by the insurance company in a separate account and do not constitute surplus in the account.

Section 263. Indirect investment in local government securities.-

A prudent expert fiduciary may invest retirement system assets in a pooled investment fund of a bank, a pooled separate account of an insurance company, or the securities of an investment company registered under Public Law 76-768, Title I, 54 Stat. 789, known as the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), whose shares are registered under Public Law 73-22, Title I, 48 Stat. 74, known as the Securities Act of 1933 (15 U.S.C. § 77a et seq.), provided that not more than five percent of the fair market value of the assets of the pooled investment fund, pooled separate account, or investment company are invested in the debt securities of the local government that created the retirement system or of which the retirement system is a part.

Section 264. Investments that become unauthorized.-

A fiduciary may retain without liability for resulting loss any investment that was authorized when received or made although that investment no longer qualifies as an authorized investment, provided the fiduciary exercises the due care and prudence required by this statute in the disposition or retention of that nonlegal investment. A retirement system shall dispose of an investment that was authorized when received or made but that no longer qualifies as an authorized investment within five years of the investment ceasing to qualify as an authorized investment at the disposition rate of not less than twenty percent of the unauthorized investment a year.

CHAPTER 3

ADMINISTRATIVE PROVISIONS

Section 301. Open meetings.-

A managing board is an agency under the act of July 3, 1986 (P.L.388, No. 84), known as the Sunshine Act.

Section 302. Inspection and copying of records.-

A retirement system is an agency under the act of June 21, 1957 (P.L. 390, No. 212), relating to the inspection and copying of public records.

Section 303. Plan document.-

(a) Unless the pension plan of the retirement system is contained wholly in law, the managing board shall compile one written plan document and file it with the chief administrative officer of the retirement system. The managing board shall include in this plan document all applicable, relevant provisions of the pension plan, including eligibility requirements and entitlement provisions constituting the benefit coverage of the retirement system. The managing board shall compile this plan document from whatever documents in which it is contained including, but not limited to, the articles of incorporation, bylaws, governing body rules and policies, local government charter provisions, local government ordinance or resolution provisions, general or special Commonwealth law, and collective bargaining agreements. The managing board shall revise this plan document whenever there is a material change in the pension plan.

(b) This plan document is a public record under the act of June 21, 1957 (P.L. 390, No. 212), relating to the inspection and copying of public records.

Section 304. Contracting for investment advice permitted.-

The managing board may contract with an investment adviser that agrees to conduct itself as a fiduciary in accordance with this statute to be designated as an investment adviser of the retirement system. Under subchapter E of chapter 2, in the contract, the investment adviser may limit its fiduciary liability to the portfolio of assets under its control and over which it has assumed fiduciary responsibility.

Section 305. Contracting for investment management permitted.-

The managing board may contract with an investment manager that agrees to conduct itself as a fiduciary in accordance with this statute to be designated as an investment manager of the retirement system. The contract shall require the investment manager annually to disclose to the retirement system all expenses of managing the investments of the retirement system. Under subchapter E of chapter 2, in the contract, the investment manager may limit its fiduciary liability to the portfolio of assets under its control and over which it has assumed fiduciary responsibility.

Section 306. Contracting for retirement system administration permitted.-

The managing board may contract with an insurance company that has qualified and is authorized by the Insurance Department of the Commonwealth to transact business in the Commonwealth, or with any bank approved by the Department of Banking of the Commonwealth, or with any investment adviser registered under Public Law 76-768,

Title II, 54 Stat. 847, known as the Investment Advisers Act of 1940 (15 U.S.C. § 80b-1 et seq.), that is registered as an investment adviser by the Pennsylvania Securities Commission, or with the Pennsylvania Municipal Retirement System to be designated as the retirement system administrator. Under subchapter E of chapter 2, the managing board may delegate the power to administer the retirement system in its entirety, including the power to receive and invest all moneys deposited into the pension trust fund and such other delegable powers as are vested in the managing board. The contract shall require the retirement system administrator annually to disclose to the retirement system all expenses of operating and administering the retirement system.

Section 307. Disclosure of business placed or commissions allocated.-

The managing board annually shall issue a public document in which it discloses the recipients of any business placed or commissions allocated among any commercial banks, investment bankers, insurance companies, or brokerage organizations used by that retirement system.

Section 308. Administrative remedies.-

Unless the pension plan of the retirement system is contained wholly in law, the managing board shall provide in the plan document for an appeals procedure for benefit determinations that are adverse to the interests of a member or beneficiary. This appeals procedure shall be under Title 2 of the Consolidated Pennsylvania Statutes (relating to administrative law and procedure). An aggrieved person can only appeal to the courts in accordance with Subchapter B of Chapter 7 of Title 2 of the Consolidated Pennsylvania Statutes after exhausting the administrative remedies required by this section under Subchapter B of Chapter 5 of Title 2 of the Consolidated Pennsylvania Statutes.

CHAPTER 4

PENALTIES

Section 401. Compensatory damages.-

A fiduciary who violates a provision of this statute is personally liable to pay an amount equal to the loss, or the profits made using the assets, or both to the retirement system, member, beneficiary, or some combination of these, whichever suffered the loss or was entitled to the assets.

Section 402. Other equitable or remedial relief.-

(a) A fiduciary whose violation of a provision of this statute is the result of negligence beyond simple negligence or inadvertence but less severe than gross negligence is subject to other equitable or remedial relief as the court may deem appropriate, including:

- (1) an injunction requiring the fiduciary to perform or refrain from performing an act or acts; and
- (2) a writ of mandamus requiring the fiduciary to perform a fiduciary act or duty.

(b) A fiduciary whose violation of a provision of this statute is the result of gross negligence or is willful or malicious shall be removed from that fiduciary's fiduciary position and is subject to other equitable or remedial relief as the court may deem appropriate.

Section 403. Criminal penalties.-

A fiduciary who participates in the investment or management of retirement system assets, the disbursement of money from a retirement system, or the formulation or approval of a contract on behalf of the retirement system and who is not covered by the bond or alternative security arrangement specified in section 254 of this statute is guilty of a misdemeanor of the third degree.

Section 404. No limitation on other penalties.-

(a) The penalties prescribed in this statute do not limit:

- (1) the power of the Commonwealth, a Commonwealth retirement system, a local government, or a local government retirement system to discipline its officials or employees;
- (2) the power of the State Ethics Commission under the act of October 4, 1978 (P.L. 883, No. 170), relating to conflicts of interest and financial disclosures by public officials and public employees;
- (3) the power of the court under the act of August 14, 1963 (P.L. 1048, No. 452), relating to the forfeiture of office of public officers convicted of certain crimes;
- (4) the power of either House of the General Assembly to discipline its own members or impeach a public official; or
- (5) the power of removal under section 7 of article 6 of the Pennsylvania Constitution.

CHAPTER 5

SAVINGS CLAUSE, REPEALS, AND EFFECTIVE DATE

Section 501. Saving clause.-

The provisions of this act shall not affect an act done, liability incurred, or right accrued or vested, or affect a suit or prosecution pending or to be instituted to enforce a right or penalty or punish an offense under the authority of an act or part thereof repealed by this act.

Section 502. Repeals.-

All acts and parts of acts are repealed in so far as they are inconsistent herewith.

Section 503. Effective date.-

This act shall take effect on the first day of January that occurs 60 days after the date of final enactment of this act.