Ten Ways That Trustees Leave Money on the Table

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Overview

- After suffering steep loses during the financial crisis and recession, U.S. public pension funds' investments are making gains
  - 3 straight quarters of gains for the 100 largest public employee retirement systems (holdings now **$2.6 trillion** (as of 3/31/11))

- Despite improved returns, the funded ratios for U.S. pension funds continues to decline

- **C + I = B + E** (Contributions + Investment Returns = Benefits Paid + Expenses)

- Our Goal: Provide some ideas you can implement in your plans to improve performance/functionality, help reduce the "E", and add to the overall "I"

#1 Do You have an RFP Process?

Do You Have an RFP Process?

- Consider implementing a formal process to refresh your service providers every few years
  - Industry leaders change and you want to have the best people working for your plan
- Benefits
  - Internal alignment – lay out your needs before involving a vendor
  - Accurate proposals – get the info you want from vendors, not what they want to tell you
  - Comparable solutions – apples to apples; not "hey, I met this vendor at a conference…"
  - Oral Presentations – easy to look good on paper, harder to do so in person
  - Cost/time in doing the RFP can be easily off-set by improvements to plan performance and functionality
- Should you get help?
  - Run internally vs. have consultant/third party handle it
    - **Factors to consider: in-house expertise, staff time, internal buy-in to develop RFP yourself**
- Lycoming County Experience/Process

#2 Are You Sure That Retiree is Still Living? Compliance Audit Importance

Compliance Audit Importance

- During tough economic times compliance lessens
- Most trustees believe increasing compliance leads to increased net revenue
- Make sure you have a system for conducting audits in each area of the system's affairs to ensure money is being spent wisely
- Example: Retiree Deaths
  - Direct deposits, joint accounts, unreported deaths
  - Difficult to recover money already paid
  - Death search services available at minimal cost (run file every other month)

#3 Plans Resist Going Paperless and/or Fail to Outsource Certain Office Functions

Plans Resist Going Paperless and/or Fail to Outsource Certain Office Functions

- Require direct deposit for monthly pension checks
- Investigate whether other printing, stuffing and mailing services can be done cheaper
- Bulk Postage: First class mail vs. pre-sorted 1st class rates
- Advantages of going paperless for office functions
  - **Doing plan business remotely**
  - **Ease in disseminating**
  - **Hedge against disaster**
  - **Reduces office footprint**
  - **Productivity improvement reduces time in:**
    - **Searching thru files**
    - **Faxing**
    - **Mailing**
    - **Filing**

Plans Resist Going Paperless and/or Fail to Outsource Certain Office Functions(continued)

- Advantages of going paperless (continued)
  - **Promotes efficiency**
  - **Environmentally friendly**
  - **Improved service when plan members call the office**

- Should calculate ROI on going paperless

- Improvements at Lycoming County

#4 Are You Checking Your Investment Management Fee Bills?

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- **Investment management fees are often the most costly element of the total administrative expense for plans**
- Are they fair and appropriate?
- Rates have come down
- Are you on "Old" schedule?
- Breakpoints
- Transparency
- Cross-check
- War Stories

#5 Are You Checking Your Custody Fee Bills?

Are You Checking Your Custody Fee Bills?

- **Types of fees:**
  - Asset Based
  - Transaction – Definition?
  - Per Account
  - Minimums

- **What determines if they are fair and appropriate?**
  - **Services provided**
  - **Quality of service**
  - **Technology provided**
  - **Level of service provided**

- **War Stories – $140,000**

#6 Are You Checking Your Transaction Fees?

Are You Checking Your Transaction Fees?

- **Equities – Explicit**
  - ¢/share
  - Ticket charge?
- **Fixed – Usually not Explicit**
  - Spread
- **Market Impact**
- **War Stories – 24¢/share**
  - **Trade Institutionally**

#7 Are You Diligently Taking Advantage of the IRC Automatic Rollover Rules?

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- IRC Sec. 401(a)(31)(B): automatic rollover rules adopted by Congress in 2001 do apply to governmental plans

- "Mandatory Distributions": County plan can tell participant these distributions will be placed in an IRA established by the County if no affirmative election is made by the participant (cash or IRA/qualified plan rollover)
  - Must give participant reasonable amount of time to respond
  - Must identify the IRA rollover provider to the participant
  - For County plans this applies to refunds of accumulated deductions to contributors who terminate service before qualifying for a retirement allowance or who terminate service before completing five years of service, as required in section 23 of Act 96, the County Pension Law

- This resolved an administrative and economic headache for County plans
  - Mercer County credits 5.5% on employee contributions
  - County must have taken Board action to benefit from the automatic rollover rules and be sure to monitor each outgoing employee, comply with the IRC requirements, and save County money

#8 Are You Meeting Frequently Enough?

Are You Meeting Frequently Enough?

- Many PA systems meet quarterly
  - Can create difficulty in implementing new investment strategies
  - Want to enable trustees to discuss issues facing the system collectively to resolve small problems before they become larger ones
- Consider going to once a month or every other month
  - Other option – create sub-committee meetings to deal with pressing issues
- Increase vendor attendance
  - Make vendors explain their performance more often
  - Ask more questions of your service providers

#9 Failing to Take Advantage of Trustee Educational Opportunities

Failing to Take Advantage of Trustee Educational Opportunities

- Regular attendance helps trustees fulfill their fiduciary duty to plan members
- Learn what innovative steps your colleagues are implementing at their plans
- Trade successes and failures
- Obtain vendor referrals from other plans (to include in future RFP issues)
- Refresh on the basics and learn about legislation and regulations that impact your plan
- Nothing takes the place of being there

#10 Failing to File Proofs of Claim: Recovering Money Rightly Owed to Your Pensioners

Failing to File Proofs of Claim: Recovering Money Rightly Owed to Your Pensioners

- Given economic events of the past two years and the current state of the pension plan system, institutional investors can and should work to retrieve money rightly owed to their funds while fulfilling their fiduciary duty through proper filing of proofs of claim in securities class actions

- Fiduciary Duty: In the past five years both mutual fund managers and brokerage houses have been sued by shareholders for breach of fiduciary duty for alleged failure to file proof of claim forms.
- Courts have not addressed issue of whether an institutional investor has a fiduciary duty to file claim forms, though many have opined that there is a legal duty to do so.

- Statistical Data: 2005 independent academic study found that only **28%** of institutional investors filed claims

- Since that study (2005-2010) there have been 672 class action settlements totaling over $47 billion in settlement proceeds

- Institutional investors failure to file produces a windfall for those that do file

- NYCERS recovered almost $20 million from 2007-2008 in class action settlement money

Failing to File Proofs of Claim: Recovering Money Rightly Owed to Your Pensioners

- **Some Reasons Institutions Fail to File**:
  - 1) Assuming someone is already taking care of it;
  - 2) not receiving the settlement notice (unaware of the settlement);
  - 3) the perception that the cost associated with filing the proof of claim is greater than any potential recovery;
  - 4) the difficulty institutions have in securing and maintaining access to historical data needed to file claims (often long class periods, changes in custodian); and
  - 5) general confusion with the forms and the securities.

- **What Can be Done?**: Putting a system in place to make sure all claims are identified and filed. Options include:
  - 1) **utilizing internal staff;**
  - **2) negotiating with a custodian to perform this service;**
  - **3) hiring a third-party claims advisory service; and**
  - **4) engaging external securities litigation counsel.**

Failing to File Proofs of Claim: Recovering Money Rightly Owed to Your Pensioners

- <u>Conclusions</u>: As of Q1 2011, approximately $26 billion in class action settlements and SEC civil penalties were awaiting disbursement to investors.

- Given the confluence of issues facing pension plans, it is essential, now more than ever, to ensure that a proper system is in place to actively track and manage class action claims.

- Implementing such a system is a wise safe harbor that allows institutional investors to fulfill their fiduciary obligations, fend off potential litigation and most importantly recover monies from class action settlements.

- If doing claims internally or utilizing your custodian, it may be wise to hire a firm that will audit the process to make sure nothing is missed

Failing to File Proofs of Claim: Recovering Money Rightly Owed to Your Pensioners

Benefits to Institutional Investors of Being Involved in Shareholder Litigation

- Selecting Counsel and Negotiating Legal Fees: Institutional investors are able to establish more competitive contingent fees with their counsel. As a result, the class is benefitted by a return of a larger portion of the settlement.

- Settlement Discussions: Lead plaintiffs are active in all negotiations relating to the size of financial recovery, the make-up of the consideration, and the proposed plan of allocation for distribution. Studies have shown that the presence of an institutional lead plaintiff is directly correlated with larger settlement size (**85 out of top 100 settlements**).

- Standing for Different Securities: A plaintiff is required for each type of security a company has, Courts regularly dismiss claims where plaintiffs lack standing. The Lehman Brothers case is a perfect example.

- Step Up to the Plate: While there are a growing number of institutions that are seeking to be lead plaintiffs in class actions, those investors have begun speaking out against "free-riders" – institutional investors that rarely or ever serve as lead plaintiff, yet always participate in securities class recoveries.