

FIDUCIARY DUTIES – AVOIDING CONFLICTS OF INTEREST TRAINING FOR MONTANA TEACHERS’ RETIREMENT SYSTEM BOARD MEMBERS

What does “conflict of interest” mean to a fiduciary?

A fiduciary has a conflict of interest if the fiduciary has a personal, professional, or commercial interest or relationship that might reasonably be perceived as diminishing the fiduciary’s independence of judgment in the conduct of trust business. A conflict of interest may exist, not only where the fiduciary’s judgment may actually be impaired by the conflicting interest, but also where there may only be an “appearance of impropriety.” In other words, a conflict of interest will not always be judged on the basis of whether or not the fiduciary’s judgment was actually colored by the conflicting interest. For a fiduciary, an unmitigated conflict of interest constitutes a violation of the fiduciary duty of loyalty.

How do you know what constitutes a conflict of interest?

The world of conflicts of interest in the fiduciary universe has been fairly exhaustively determined through the common law and through statutory enactment. ERISA has codified a number of “prohibited transactions” and identified a number of other types of conduct that are prohibited by pension plan fiduciaries. While ERISA does not apply to public pension plans, those same prohibited conducts have been generalized and applied as conflicts of interest in public pension plan litigation. As well, most states have some degree of codification of conflict of interest standards that pertain to public pension fiduciaries, at least as public employees.

Conduct that constitutes a conflict of interest, in general terms, includes:

- Exercising fiduciary discretion in the interests of any party other than the plan beneficiaries
- Receiving gifts, remuneration, or other tangible or intangible benefits in exchange for the exercise of fiduciary authority
- Utilizing plan assets or otherwise exercising fiduciary authority in a manner that personally benefits the fiduciary or the fiduciary’s account (exceptions apply)
- Having a personal interest in the business affairs of the plan, including interests in contracts and investments
- Causing or allowing the sale, exchange, or lease of any property between the plan and a party in interest
- Causing or allowing a loan or extension of credit between the plan and a party in interest
- Causing or allowing the furnishing of goods, services, or facilities between the plan and a party in interest
- Causing or allowing the transfer of plan assets to a party in interest or the use of plan assets by or for the benefit of a party in interest

- Acquisition of employer securities or employer real property in excess of the limits set by law
- Acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or its participants or beneficiaries
- Receiving any consideration from any person dealing with the plan in connection with any transaction involving plan assets

A “party in interest” is: 1) any fiduciary, counsel, or employee of the plan; 2) a person providing services to the plan; 3) an employer with any employee covered by the plan and any direct or indirect owner of such employer; 4) a relative of any of the persons described in (1),(2), or (3); 5) any employee organization with any member covered by the plan; 6) a corporation, partnership, estate, or trust owned in part by any person or organization described in (1), (2), (3), (4), or (5); 7) officers, directors, major shareholders, and employees of any person or organization described in (2), (3), (5), or (6); 8) a partner or joint venture with any person or organization described in (2), (3), (5), or (6).

Are there “exceptions” to the identified conflicts of interest?

There are many exceptions, limitations, and refinements to the conflicts of interest described above, including that it will not be a conflict of interest if:

- A fiduciary is a member, retiree, or beneficiary of the retirement system, and/or with respect to any matter at issue, the fiduciary’s interest is no greater than a large class of its members or retirees
- A fiduciary is a member or officer of a union or employee organization with the plan sponsor’s agency, though there may be a conflict of interest if the fiduciary participates as a member of the employer’s or union’s negotiating team, and there will likely be a conflict of interest if the fiduciary, as a union officer or representative or employer representative, directly represents or has represented a plan member or members in a matter that is before the retirement system.

What must I do if I have, or think I have, a conflict of interest?

Of course, it is always best not to have a conflict of interest (seriously). You, as an individual fiduciary, are in the best position to know whether you (or family members) have personal or business interests that are in conflict with your duty of loyalty to the retirement system and its beneficiaries. If you have inherent conflicts, it is incumbent upon you to disclose them, and to eliminate those conflicts that will repeatedly impair your ability to perform the functions required of you on behalf of the retirement system, or discontinue your service on the Board. (Remember that an appearance of impropriety (an appearance of a conflict of interest) may constitute an actual conflict of interest and may be as disruptive to the functioning of the retirement system as a more material conflict.)

Some conflicts of interest may be mitigated by full disclosure of the circumstances of the conflict. The determination that a conflict of interest may be adequately mitigated by disclosure is generally a determination for the Board chair to make, with advice of legal counsel. If a determination is made that the conflict may be mitigated through disclosure, the record of any Board action taken in a matter in which the conflict arises should include a reasonably detailed statement of the conflict.

In most cases, however, conflicts of interest are appropriately managed through full disclosure of the circumstances of the conflict, and abstention of the conflicted fiduciary in any Board action taken in the matter giving rise to the conflict. While it is not absolutely mandatory, best practice in the arena of conflict of interest management is leaning in recent years in favor of the conflicted fiduciary not only abstaining from voting in the matter, but abstaining from all discussion and comment on the matter. Many states have enacted statutes or policies that require the conflicted fiduciary leave the room during discussion and action on the matter.

Conflicts of interest will arise. It is important to you, as an individual fiduciary, to the Board as a whole, and to the retirement system and its beneficiaries that conflicts be identified, assessed, and properly managed. Any fiduciary who believes he/she may have a conflict of interest, whether a general concern or related to a specific issue to be addressed by the Board, needs to bring that potential conflict to the attention of legal counsel or the executive director as quickly as possible so that resolution/management of the conflict can be implemented in the manner that least disrupts the functioning of the Board and the retirement system. To that end, the following steps are recommended:

- As soon as you are aware of an actual or potential conflict, bring your concern to the attention of the Executive Director or Chief Legal Counsel
- Chief Legal Counsel will confer with you to understand the specific facts and circumstances at issue, and will determine whether a conflict of interest exists, and, if so, how the conflict of interest would appropriately be managed
- The Executive Director and/or Legal Counsel will inform the Board chair of the potential conflict of interest and the recommended process for resolution
- If time allows, Chief Legal Counsel may prepare a written determination of whether a conflict of interest exists, and the appropriate means of managing the conflict
- Legal Counsel will prepare any necessary disclosure statement to be placed on the record at the time of Board consideration/action in the matter giving rise to the conflict