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Illinois Chief Pension Administrator Cites the Importance of Investment Policy, Full Disclosure and the Fiduciary Status of Advisors

Thomas R. Jones, Chief Administrator, Pension Division, Illinois Department of Insurance

Editor's Note: Tom Jones has a very interesting perspective as the pension administrator for the State of Illinois. First, in Illinois, any advisor providing advice or providing investment products to a pension plan is a fiduciary, thus nullifying any arguments to the contrary by the brokerage industry. Second, in monitoring the boards of the municipal police and firefighters pension funds for compliance to state laws which establish investment authority, Tom has the important education responsibility of making sure his pension boards understand their role and how they will be evaluated. This discipline does not have a counterpart in the private sector but is invaluable in elevating the effectiveness of pension plan administration and management. In this article, Tom is coaching his police and firefighter boards on how to use investment advisors and investment services, citing the importance of the advisor acknowledging in writing their fiduciary status, the importance of each board creating an investment policy statement, the importance of full disclosure and the importance of quarterly accountability for the advisors. This reminds us how underserved the pension market is, how important the unconflicted counsel of the advisor is and how invaluable the work of Tom Jones is in holding pension boards accountable. Pension boards have a lot to learn. Just picture Tom addressing his police and firefighter boards with the following advice – maybe it is something you can use with your pension boards.

This coming year the Pension Division's focus will be on investment statutory requirements concerning investment policies, investment contracts, fee disclosure and recordkeeping. There is a lot of money in downstate and suburban police and firefighters pension funds, almost $7 billion. When you have a lot of money, you have a lot of friends. State laws determine the investment authority for pension boards and investment professionals, and it is the responsibility of the Pension Division to monitor pension fund boards compliance.

Pension fund trustees need a basic understanding of investing because the ultimate responsibility for the safety of the funds rests with pension board. What basics do trustees need to know about investments? Who are the players? What should a pension board expect from investment managers, investment advisors, brokers, custodians and investment consultants? A trustee needs to understand some basic investment language, like "stocks," "bonds," "mutual funds" and "annuities," within the context of actuarial assumptions, risks, asset classes – debt and equity – and asset allocation. There should also be a documented process for investment polices, the board's framework for investment activities.

> **REMEMBER YOU ARE INVESTING IN A REGULATORY ENVIRONMENT, SO UNDERSTAND WHAT YOUR DUE DILIGENCE RESPONSIBILITIES ARE ...**

Remember you are investing in a regulatory environment, so understand what your due diligence responsibilities are under the Illinois Pension Code, e.g., fee disclosure, to get the true cost of investments. Also, keep in mind how vital good recordkeeping is to fulfilling due diligence.

Here are some of the areas and key points concerning investment authority of Articles 3 and 4 Pension Funds that the Division will be closely monitoring. In state legislative language, the word "may" contains options; the word" *shall*" does not.

40 ILCS 5/1-113.5 Investment Advisors and Investment Services

Pension funds may appoint investment advisors, if the pension fund with net assets of $5 million or more, investing in common or preferred stocks. The fund *shall* appoint an investment advisor before making such investments. The investment advisor *shall* be a fiduciary and *shall* have a written contract in accordance with the board's investment policy. The contact *shall* include all of the following:

1. acknowledgement in writing by the investment advisor that he or she is a fiduciary with respect to the pension fund;
2. the board's investment policy;
3. full disclosure of direct and indirect fees, commissions, penalties, and any other compensation that may be received by the investment advisor, including reimbursement for expenses; and
4. a requirement that the investment advisor submit periodic written reports, on at least a quarterly basis, for the board's review at its regular scheduled meetings.

All returns on investment *shall* be reported as net returns after payment of all fees, commissions, and any other compensation. Thirty days after appointing an investment advisor, the board *shall* submit a copy of the contract to the Department of Insurance. The Division will be reviewing investment contracts to see if they include the statutory requirements in 40 ILCS 5/1-113.5.

40 ILCS 5/1-113.6. Investment Policies

Every board of trustees of a pension fund *shall* adopt a written investment policy and file a copy of that policy with the Department of insurance within 30 days after its adoption. Whenever there is a change its investment policy, it *shall* file a copy of the new policy with the Department with 30 days.

The Pension Board should develop an investment policy as part of a process with deliberations. Investment policy should not be just a form-filling exercise. It is a written document adopted by the board of trustees which presents (1) the investment goals established by the board, (2) the strategies to be used in the pursuit of its goals, (3) the persons designated to execute the board's policies, (4) the entities with which the board has decided to conduct business and (4) the measures put into place by the board with which to periodically evaluate the success of it policies.

A statement of investment policy differs importantly from a statement of investment objectives. An investment object (such as a performance standard) is a desired result. An investment professional cannot implement an objective; he or she may only pursue a course of action, consistent with investment policy, which offers a reasonable likelihood of realizing the objective. ■

About the Author

As Chief Administrator of the Illinois Department of Insurance, Thomas R. Jones is in charge of the Pension Division, responsible for monitoring and compliance of all public pension funds in the State of Illinois. There are 276 downstate and suburban fire funds, 342 police funds, and 15 large statewide, Chicago and Cook County Retirement Systems. For more information about Illinois regulatory requirements for pension funds, visit the Department of Insurance's web site at http://www.ins.state.il.us.

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