

August 11, 1971

SUBJECT: INSURANCE

CIRCULAR LETTER NO. 3 (1971)

August 11, 1971

TO ALL TRUSTEES OF EMPLOYEE WELFARE AND PENSION FUNDS SUBJECT TO ARTICLE III-A OF THE NEW YORK STATE INSURANCE LAW

RE: GUIDELINES FOR THE EXERCISE OF INVESTMENT RESPONSIBILITIES BY TRUSTEES OF EMPLOYEE WELFARE AND PENSION FUNDS SUBJECT TO ARTICLE III-A OF THE NEW YORK STATE INSURANCE LAW

PURPOSE

Article III-A of the New York State Insurance Law authorizes the Insurance Department to regulate certain employee welfare and pension funds "established or maintained jointly by one or more employers together with one or more labor organizations ..." (Section 37-a). Under its authority the Insurance Department has ruled that trustees of such funds may not delegate powers involving the unlimited exercise of discretion in the management or investment of the fund's assets (See Section 37-1(1). This ruling was published in the Department's Monthly Bulletin, December 1970.)

The Insurance Department, however, recognizes that trustees often engage qualified professional investment advisers to assist them in the management and investment of funds. The guidelines set forth below, which are not intended to be exclusive, reflect the Department's interpretation of the permissible limits of discretion which trustees may exercise in selecting an investment adviser and in authorizing that adviser to take certain limited actions with respect to the management and the investment of the assets of the fund. In examining funds under its jurisdiction, the Department will use these guidelines to measure the performance of the trustees in discharging their responsibilities as fiduciaries.

GUIDELINES

1. In selecting an adviser the trustees must determine that the adviser is professionally and financially responsible. Factors relevant to this determination should include:

- (a) The adviser's registration, if required, under the Investment Advisers Act of 1940;
- (b) The adviser's registration, if required, as an investment adviser in the State of New York, and
- (c) The adviser's trustworthiness and general reputation in the financial community.

2. The trustees must determine the investment policy of the fund. Any agreement between the trustees and their investment adviser with respect to the implementation of that policy must be in writing and must include in detail:

- (a) The terms and conditions of the adviser's compensation;

(b) The investment services which the adviser promises to provide, including (i) notification promptly in writing of any purchase or sale made in accordance with the Agreement and (ii) periodic statements, on at least a quarterly basis, valuing the fund's portfolio at fair market value or upon such other method of valuation as may be deemed by the trustees to be reasonable and necessary under particular circumstances;

(c) A provision that the Agreement is terminable by the trustees immediately upon written notice to the adviser, and

(d) The specific, limited actions which the adviser is authorized to take with respect to the investment of the assets of the fund.

3. In specifying the authority to be granted to the adviser in the Agreement, the trustees should include, where appropriate:

(a) The maximum percentage or fixed dollar amount of the fund which shall be invested in debt securities;

(b) The type of debt security which constitutes a permissible investment, e.g., a debt security having a nationally recognized rating.

(c) The maximum percentage or fixed dollar amount of the fund which shall be invested in securities issued by corporations engaged in each of several specified industries;

(d) The maximum percentage or fixed dollar amount of the fund which can be invested in securities issued by any one company;

(e) The maximum percentage of the outstanding stock of any company which can be purchased for the fund;

(f) A requirement that investments in equity securities shall be limited to securities of corporations listed on a national securities exchange or traded over the counter, except that investments in securities traded over the counter shall be limited to such securities listed with NASDAQ or determined to be "marginable" pursuant to the applicable Regulations of the Federal Reserve Board;

(g) A requirement that investments shall be made only in securities of corporations which have a certain record of earnings and dividends over a specified period of time;

(h) The maximum percentage or a fixed dollar amount of the fund which shall be maintained in cash or cash equivalents, including United States government obligations with a short maturity, State or municipal obligations or commercial obligations of high quality with short maturities;

(i) A prohibition against investing in securities used for, or engaging in transactions involving: puts, calls, straddles, stock options, arbitrage, short sales and purchases on margin;

(j) A prohibition against borrowing money in the name of the fund to purchase securities.

4. The adviser shall not engage in any transaction, including those set forth in paragraph No. 3 above, which exceeds the scope of his express authority without obtaining prior authorization in writing from the trustees. A provision

to this effect should be included in the written Agreement between the trustees and their adviser.

5. The actions taken by the adviser, as well as the investment policy of the fund, shall be continuously reviewed and affirmed by the trustees.

6. The trustees shall meet with the adviser on a regular basis, and at such meetings, shall discuss and review with the adviser:

- (a) the present holdings in the account;
- (b) any changes made in the account during the preceding period;
- (c) the reasons for such changes and the results achieved thereby;
- (d) the investment activity of the trust for the period, including the rate of portfolio turnover; and
- (e) any other factors which the trustees consider pertinent to an analysis of financial performance and planning, and consistent with their obligations as fiduciaries.

All trustees are hereby reminded that, pursuant to paragraph (2)(f) of subsection (A) of Regulation Number 38(11 NYCRR 201) any Agreement entered into between them and any financial or investment adviser or manager must be filed with this Department.

All trustees please acknowledge in writing receipt of this circular letter to James J. Higgins, Supervising Examiner, Welfare Fund Bureau, New York State Insurance Department, 55 John Street, New York, New York 10038.

[SIGNATURE]

Superintendent of Insurance