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Description of document: Railroad Retirement Board (RRB) Inspector General (OIG) and General Counsel records regarding oversight of the National Railroad Retirement Investment Trust (NRRIT), 2012

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Source of document: Chief FOIA Officer
General Counsel
Railroad Retirement Board
844 North Rush Street
Chicago, Illinois 60611-2092
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[E-FOIA: Online FOIA Request Form](#)

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UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
844 NORTH RUSH STREET
CHICAGO, ILLINOIS 60611-2092

GENERAL COUNSEL

NOV 5 2013

Re: Freedom of Information Act
Request dated October 9,
2013, C.0119-14

This is in response to your letter dated October 9, 2013, to the Railroad Retirement Board (hereinafter the Board) wherein you requested the following:

- 1) A copy of the RRB OIG Memorandum dated August 30, 2012 in which the OIG addressed concerns regarding oversight of NRRIT;
- 2) A copy of the response provided to OIG by NRRIT; and,
- 3) A copy of the RRB General Counsel legal opinion regarding this concern.

You made your request pursuant to the Freedom of Information Act.

Pursuant to your request, please find copies of those documents enclosed.

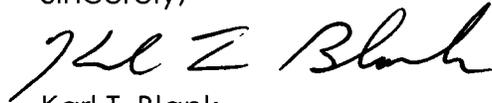
I trust that this information is helpful.



Appeal Rights.

The regulations of the Railroad Retirement Board provide that you may appeal the denial of a requested record by writing to the Secretary to the Board, Railroad Retirement Board, 844 North Rush Street, Chicago, Illinois 60611-2092, within 20 days following your receipt of this letter. A letter of appeal must include reference to, or a copy of, this letter.

Sincerely,

A handwritten signature in black ink that reads "Karl T. Blank". The signature is written in a cursive style with a large, stylized "K" and "B".

Karl T. Blank
General Counsel

Enclosures



UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

Memorandum

August 30, 2012

TO: Michael S. Schwartz
Chairman

FROM: Martin J. Dickman
Inspector General

SUBJECT: NRRIT Investment Staff and Trustee Compensation

This memorandum reiterates my ongoing concerns regarding the apparent lack of meaningful oversight into the activities of the National Railroad Retirement Investment Trust (NRRIT). Specifically, this memorandum addresses the significant compensation, bonus, and incentive payments made to the NRRIT's investment staff in recent years. Additionally, it also addresses the continuously increasing, and unsubstantiated, administrative expenses paid to the NRRIT.

By reviewing publically available documentation from the Foundation Center (<http://foundationcenter.org>), we were able to obtain a glimpse into the NRRIT's excessive compensation structure. For example, during fiscal year (FY) 2007 through FY 2011, the total compensation paid to the NRRIT investment staff, as reported to the Internal Revenue Service on Form 990, *Return of Organization Exempt from Income Tax*, ranged from \$1.5 million to \$3.0 million annually. This amount does not include additional compensation expenses, as reported on the NRRIT's financial statements, which totaled \$5.6 million but could not be traced, based upon publically available records, to specific employees (Table 1). Additionally, during this five year period, the investment staff's compensation included annual unspecified deferred and non-taxable compensation ranging from \$5,911 to \$674,619 (Table 2).

I was alarmed to see that from FY 2007 through FY 2009, when the NRRIT's net assets declined by more than 28% (Table 4), William J. Raver, the NRRIT's former Chief Executive Officer (CEO) and Chief Investment Officer (CIO), received compensation from the NRRIT totaling more than \$2.2 million (Table 1).

Additionally, I noted an apparent compensation disparity among the trustees. Most notably, as reported during FY 2007 through FY 2011, the independent trustee, John W. MacMurray was paid between \$1,300 to \$3,300 per day which resulted in compensation totaling \$502,000, while the remaining trustees served in a volunteer capacity and did not receive any payment. The compensation paid to Mr. MacMurray appears unjustified as the trustees are only required to serve 2-3 days per month (Table 5).

Article II, Section 4 of the NRRIT's bylaws, titled *Compensation*, states that the independent trustee shall be entitled to receive "reasonable compensation" for services to the Trust. Compensation averaging in excess of \$2,800 per day is not reasonable for services including chief investment officer recruitment, investment strategy research and monthly board meeting presentations. Mr. MacMurray's responsibilities resemble those of an independent contractor and overlap those of the investment staff which generates conflict of interest and trustee "independence" concerns.

In October 2007, in response to the concerns of Senator Charles Grassley and the United States Senate Finance Committee, the Panel on the Nonprofit Sector, released *Principles for Good Governance and Ethical Practice*. These principles can be applied to the NRRIT. For example, Principle 20 states that, "[b]oard members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties."

Of further concern is the annual bonus and incentive payments for the 12 primary members of the NRRIT's investment staff totaled \$1,995,657 for FYs 2008 through 2011; with many staff receiving awards each year ranging in excess of \$50,000 to as high as \$450,000 (Table 3). It is important to note that the bonus and incentive payments for the investment staff were not disclosed publicly prior to FY 2008.

The compensation for the investment staff is established by the NRRIT's Board in consultation with the CEO/CIO and reviewed annually by the NRRIT's Board and its Administrative Committee. In 2007, the NRRIT's Board and Administrative Committee engaged the Watson Wyatt consulting firm to provide guidance on the compensation structure of the NRRIT investment staff. The job descriptions and responsibilities established for these investment positions have not been released for public examination. Additionally, the rationale and accountability for this level of compensation, bonus, and incentives during a period of continuing investment decline has not been publicly disclosed.

Federal bonus and incentive payments are usually tied to excellent or outstanding performance; however, there does not appear to be a similar link to performance for the NRRIT's investment staff. Further, the President established a Federal pay freeze during 2011 and under the President's direction the Office of Management and Budget and the Office of Personnel Management have jointly imposed a limit on awards to Federal professional staff. With regard to bonus and incentive payments, the NRRIT does not appear to be following the government's lead.

In our September 21, 2011 *Proposal to Improve Business Efficiency at the Railroad Retirement Board*, we reported a pattern of rising administrative expenses that is contrary to the decline in value of the NRRIT's net assets. This trend continued during FY 2011 as administrative expense increased by 7.6% to \$83.1 million (Table 4).

The NRRIT's financial statements disclosed that investment management fees, compensation, and professional fees represent more than 90% of their administrative expenses; however, explanatory details to substantiate these significant annual costs are not being released to the Railroad Retirement Board (RRB) and its constituents (Table 4). We believe that the NRRIT's failure to release this information results in a serious lack of financial transparency.

As you know, lack of oversight is not a new issue. In fact we have been raising it since the NRRIT's inception. We strongly urge the RRB to:

- act on its oversight authority and responsibly enforce a sensible limit on future compensation, bonus, and incentive payments to the NRRIT's staff;
- request a detailed audit of the NRRIT's compensation practices during the questionable periods; and
- require adequate support for its administrative expenses.

Please keep me informed of the actions to be taken and provide a copy of any explanations received from the NRRIT regarding this matter.

Attachment

cc: Walter A. Barrows, Labor Member
Jerome F. Keever, Management Member
Karl T. Blank, General Counsel

Table 1: NRRIT Investment Staff and Trustee Total Compensation Reported Per IRS Form 990

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Total
Enos T. Throop Jr.	115,911	0	0	0	0	115,911
John W. MacMurray	100,000	96,000	111,000	96,000	99,000	502,000
William J. Raver	591,640	1,055,629	602,363	0	0	2,249,632
Catherine A. Lynch	325,365	325,996	477,019	441,595	593,603	2,163,578
Grace A. Ressler	198,449	246,134	225,423	260,459	322,587	1,253,052
Neal E. Kotras	174,385	214,114	200,026	228,810	286,716	1,104,051
David Locke	0	291,472	288,929	342,571	422,573	1,345,545
Caixa Y. Zeigler	0	241,802	217,519	247,173	292,412	998,906
Michael A. Reeves	0	251,879	227,874	243,262	283,745	1,006,760
Clayton Viehweg	0	175,898	186,751	194,985	248,030	805,664
Kevin McCormack	0	0	224,214	257,052	302,853	784,119
Barry Kaplan	0	0	0	164,680	188,519	353,199
Gary Green	0	175,323	213,798	262,894	0	652,015
Total	1,505,750	3,074,247	2,974,916	2,739,481	3,040,038	13,334,432

Compensation Per Financial Statements	2,980,000	4,840,000	3,219,000	3,309,000	4,651,000	18,999,000
Disclosed on IRS Form 990	1,505,750	3,074,247	2,974,916	2,739,481	3,040,038	13,334,432
Total Not Disclosed On IRS Form 990	1,474,250	1,765,753	244,084	569,519	1,610,962	5,664,568

Source: IRS Form 990 and the NRRIT's annual financial statements

Total annual compensation reported on IRS Form 990 ranged from \$1.5 million to \$3.0 million for FY 2007 through FY 2011. Another \$5.6 million reported over the five year period on the NRRIT's financial statements cannot be traced to specific employees based on available public records. The former CEO/CIO (Raver) and the independent trustee (MacMurray) reported five year compensation totaling \$2,249,632 and \$502,000, respectively.

Table 2: NRRIT Investment Staff Retirement and Other Deferred Compensation and Non-taxable Benefits

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Enos T. Throop Jr.	5,911	0	0	0	0
John W. MacMurray	0	0	0	0	0
William J. Raver	0	255,629	38,529	0	0
Catherine A. Lynch	0	20,888	48,288	72,865	131,405
Grace A. Ressler	0	29,180	40,946	55,293	81,982
Neal E. Kotras	0	17,426	30,588	41,997	67,846
David Locke	0	34,367	52,017	73,503	105,898
Caixa Y. Zeigler	0	22,019	32,364	48,309	70,072
Michael A. Reeves	0	32,926	43,355	48,813	66,091
Clayton Viehweg	0	9,614	21,103	22,004	43,026
Kevin McCormack	0	0	39,214	54,677	73,878
Barry Kaplan	0	0	0	29,577	34,421
Gary Green	0	26,903	35,477	45,247	0
Total	5,911	448,952	381,881	492,285	674,619

Source: IRS Form 990

Annual unspecified deferred compensation and non-taxable benefits ranged from \$5,911 to \$674,619 for the five year period from FY 2007 through FY 2011.

Table 3: NRRIT Investment Staff Bonus and Incentive Compensation

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Total
Enos T. Throop Jr.	0	0	0	0	0	0
John W. MacMurray	0	0	0	0	0	0
William J. Raver	0	450,000	200,000	0	0	650,000
Catherine A. Lynch	0	73,711	138,935	61,200	138,373	412,219
Grace A. Ressler	0	49,637	11,000	28,890	59,990	149,517
Neal E. Kotras	0	45,000	12,000	26,313	54,370	137,683
David Locke	0	58,655	17,000	43,643	85,100	204,398
Caixa Y. Zeigler	0	50,284	9,250	19,608	40,375	119,517
Michael A. Reeves	0	50,094	9,250	15,980	35,560	110,884
Clayton Viehweg	0	15,014	9,250	11,082	36,355	71,701
Kevin McCormack	0	0	9,250	23,150	44,825	77,225
Barry Kaplan	0	0	0	7,178	17,998	25,176
Gary Green	0	25,050	3,500	8,787	0	37,337
Total	0	817,445	419,435	245,831	512,946	1,995,657

Source: IRS Form 990

FY 2007 bonus and incentive payments were not reported separately during FY 2007. Annual bonus and incentive payments totaled \$1,995,657 for the four year period from FY 2008 through FY 2011.

Table 4: NRRIT Net Assets and Administrative Expenses*In Thousands*

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Total	
Net Assets	32,664,008	25,335,734	23,332,743	23,809,429	22,098,024		
Administrative Expense	75,375	71,983	63,849	77,165	83,053	371,425	
Investment Management Fees	65,943	59,328	49,510	65,242	68,401	308,424	83.0%
Compensation	2,980	4,840	3,219	3,309	4,651	18,999	5.1%
Professional Fees	2,549	3,539	2,872	2,196	3,911	15,067	4.1%
Trustee Fees and Expenses	229	209	168	269	222	1,097	0.3%
Custodial Fees	100	100	115	108	107	530	0.1%
Other Expenses	3,574	3,967	7,965	6,041	5,761	27,308	7.4%

Percentage of Administrative Expense: 100.0%

Source: NRRIT's annual financial statements

Increase in Administrative Expense from FY 2010 to FY 2011: 7.6%

Decline in Net Assets from FY 2007 through FY 2009: -28.6%

Decline in Net Assets from FY 2007 through FY 2011: -32.3%

The NRRIT's administrative expenses have increased steadily while its net assets have significantly declined. Investment management fees, compensation, and professional fees represented more than 90% of administrative expenses for the period from FY 2007 through FY 2011.

Table 5: NRRIT Compensation Paid to Single Independent Trustee

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Total
Compensation	100,000	96,000	111,000	96,000	99,000	502,000
Average Days Worked Per Year	30	30	84	30	30	
Compensation Per Day	3,333	3,200	1,321	3,200	3,300	

Source: IRS Form 990

Estimated Average Compensation Per Day: 2,871

A single NRRIT independent trustee reported compensation of approximately \$1,321 to \$3,333 per day from FY 2007 through FY 2011. The NRRIT's other trustees did not receive compensation during this five year period.

NRRIT *National Railroad Retirement Investment Trust*

1250 Eye Street NW, Suite 500, Washington, DC 20005
Phone: 202.589.0100 Fax: 202.589.0200

September 11, 2012

Mr. Karl T. Blank
General Counsel
U.S. Railroad Retirement Board
844 N. Rush Street
Chicago, IL 60611

Re: August 30, 2012 Inspector General Memorandum

Dear Mr. Blank:

The Board of the National Railroad Retirement Investment Trust has reviewed the August 30, 2012 memorandum from the Inspector General to the Railroad Retirement Board on "NRRIT Investment Staff and Trustee Compensation," and must take exception to many of the statements and conclusions in the memorandum. Our comments are set forth below.

1. Staff Compensation

IG Concern: *The IG memorandum expresses concern regarding staff compensation. These concerns relate to: the annual bonus and incentive payments received by members of NRRIT's investment staff; unspecified deferred and non-taxable compensation paid to certain staff members during this period; the fact that additional compensation expenses reported on NRRIT's financial statements could not be traced to specific employees by way of NRRIT's Form 990; and a concern that the rationale and accountability for the level of compensation, bonus, and incentives during a period of continuing investment decline has not been publicly disclosed. The memorandum also states that NRRIT, with regard to bonus and incentive payments, "does not appear to be following the government's lead" on linking bonus and incentive payments to "excellent or outstanding performance," and on "impos[ing] a limit on awards to Federal professional staff."*

By 2007, NRRIT had hired a full complement of investment staff to manage the Trust's portfolio and put into practice the investment policies that had been developed by the Trustees. During this period, hiring and staff retention in the investment community had become extremely competitive, and NRRIT realized this first hand after losing staff to other entities. As a result, the Board and its Administrative Committee engaged the Watson Wyatt consulting firm to provide advice with respect to the compensation structure of NRRIT's investment staff, including base pay, incentive compensation, and benefits. Watson Wyatt performed a detailed review of investment industry compensation practices and comparability data for different types of potential peer pension plans. Watson Wyatt's advice was a significant resource in the Board's development of a compensation and benefits structure, which is continually reviewed and, where appropriate, revised by the Board in an effort to have in place a structure that appropriately incentivizes and promotes retention of key staff.

Because NRRIT is a unique organization with elements of a corporate pension plan and elements of a public pension plan, overall compensation for senior staff (base compensation and bonus) is evaluated by reference to compensation paid for similar positions in corporate and public plans, with a higher weight being given to the compensation of public plans. Updated data is obtained annually from independent organizations that track pension industry compensation data and trends, and evaluated in the annual year-end compensation process.

The current staff bonus structure contains both quantitative and qualitative criteria. The quantitative calculations assess (i) total Trust performance against its benchmark, and (ii) its risk adjusted return. These two determinants are measured over three and five year performance periods to make sure that incentives are focused on long term performance. In addition, following its consultation with Watson Wyatt, the Board determined to institute a deferred compensation structure for senior staff in order to promote retention of these individuals. Such deferred compensation amounts for officers and senior staff are calculated as a percentage of the annual bonus earned for a year but do not vest until five years after the year in which they are earned and, thus, act as an effective retention tool. Because the deferred compensation plan did not go into effect until 2008, and amounts earned under this plan do not vest for five years, the deferred compensation amounts reported on NRRIT's Forms 990 for current staff will not be paid until 2013 and subsequent years.

With respect to the IG's claim that additional compensation expenses (beyond those of the most senior members of NRRIT's investment staff) seem to have gone unreported on NRRIT's Form 990, this is simply due to the fact that the IRS Form 990 seeks only the disclosure of compensation paid to officers, directors, trustees, key employees, and the next five highest compensated employees. NRRIT employs individuals on its staff who do not fit within these categories and, therefore, are not reported on Form 990.

Another important note about what is actually reported in NRRIT's Forms 990 is that the Inspector General's memorandum incorrectly states the aggregate compensation paid to NRRIT's staff. The Internal Revenue Service changed its reporting requirements for the FY2008 Form 990. Prior to 2008, the IRS required the reporting of compensation amounts paid during the fiscal year. Beginning in 2008, the IRS required the reporting of compensation paid during the calendar year that ended within the fiscal year being reported. Because NRRIT operates on an October - September fiscal year, this change resulted in most of the compensation that had been reported in NRRIT's Form 990 for FY2007 also being included in the Trust's FY2008 Form 990, as was specified in the latter of these Forms 990. By simply adding the totals of the two years (2007 and 2008), the Inspector General has double counted a significant amount of compensation and distorted the aggregate numbers.

With respect to the IG's claim that NRRIT does not appear to be following the government's lead with respect to linking bonus and incentive payments to excellent or outstanding performance, and on recently imposing a limit on awards to Federal professional staff, the fact remains that NRRIT is not an agency or instrumentality of the Federal government, nor is it subject to Title 31 of the U.S. Code, and its staff are not Federal employees. This separation of NRRIT from the Federal government was a clear and deliberate decision of Congress, which made several changes in the original labor and management reform proposal specifically to delink the operation of NRRIT from the Federal government. At the same time, in

developing its governance procedures for NRRIT, the Board has adopted a broad range of best practices to promote excellence in its investment selection and oversight of managers, and in its administrative operations, including staff compensation. As noted earlier, a significant portion of the staff's bonus program formula (and the linked deferred compensation program for senior staff) is established by measurement of benchmark performance and risk-adjusted performance.

2. Mr. Raver's Tenure

IG Concern: *The IG memorandum expresses "alarm" at the aggregate level of compensation received by Mr. Raver during the FY2007-FY2009 period at a time when the Trust experienced a dramatic decline in assets as a result of the 2008 financial collapse.*

In the fall of 2005, Enos Throop, the first Chief Investment Officer of the Trust informed the Board of his intention to retire from the staff. A nationwide search to find a successor was undertaken by the Board, using the services of Russell Reynolds Associates, a highly regarded national and international search firm. A substantial list of candidates was identified by Russell Reynolds and, after consultation with the Board, this list was reduced to eight candidates for in-person interviews. Mr. Raver, the then Managing Director and Chief Operating Officer of Verizon Investment Management Corp., emerged from this interview process as the candidate of choice. Mr. Raver's compensation package was established in consultation with Russell Reynolds in what was a highly competitive market for investment professionals with his senior experience. The arrangement included: (i) base compensation and an opportunity for an annual performance bonus (with a deferred compensation element), (ii) a signing/make whole bonus to be paid over five years to offset remuneration that he would be forgoing by leaving his prior employer, and (iii) a separation payment in the event he was terminated without cause. Early in 2008, the Board and Mr. Raver agreed that it would be mutually beneficial to move in a different direction with respect to Trust leadership. Mr. Raver chose to resign, effective March 31, 2008.

The amounts included in the IRS Forms 990 for FY2007-FY2009 with respect to Mr. Raver include amounts attributable to base compensation and annual bonus, the release of bonus amounts initially deferred under his contract, the acceleration of the remaining payments under his contractual signing/make whole bonus, and the separation payment that was owed under his contract. As is noted above with respect to our comment on overall staff compensation, the Inspector General's memorandum incorrectly states the aggregate compensation paid to Mr. Raver. The Internal Revenue Service changed its reporting requirements for the FY2008 Form 990 in such a way that resulted in most of the compensation that had been reported in NRRIT's Form 990 for FY2007 also being included in the Trust's FY2008 Form 990. By simply adding the totals of the two years, the Inspector General has double counted a significant amount of compensation and distorted the aggregate numbers.

3. Mr. MacMurray's Compensation

IG Concern: *The Inspector General's memorandum expresses concern about the compensation paid to the Independent Trustee (Mr. MacMurray), noting that it does not appear to be reasonable, and further notes that the remaining trustees serve in a volunteer capacity and do not receive payment. The Inspector General's memorandum also states that, according to a*

report released by the Panel on the Nonprofit Sector, whose "principles can be applied to NRRIT ... [b]oard members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties." Lastly, the Inspector General's memorandum claims that Mr. MacMurray's responsibilities generated some conflict of interest and trustee independence concerns due to some presumed overlap between his responsibilities and those of the staff.

NRRIT's statute states that the Board of Trustees shall have seven members, with three representing the interests of rail labor, three representing the interests of rail management, and one shall be an independent trustee selected by the other members of the Board. The members of the Board who represent rail labor's interests and rail management's interests participate on NRRIT's Board of Trustees as part of their employment responsibilities within the industry and are compensated by their employers for doing so. In contrast, the Independent Trustee has no connection to the rail industry and must be compensated for his or her service by the Trust. That is why the legislative history of the statute creating NRRIT and NRRIT's bylaws provide for reasonable compensation to be paid to the Independent Trustee.

In 2002, the Trust retained the Russell Reynolds executive search firm to manage a nationwide search for the Independent Trustee. Russell Reynolds associates and NRRIT's Board identified 29 candidates, all of whom were well qualified in the area of pension fund investments, and the Board conducted interviews with six of those candidates. The Board voted unanimously to select Mr. MacMurray as the Trust's first Independent Trustee. Prior to joining the Trust, Mr. MacMurray had 33 years of experience in managing large pools of investment assets, including service as Vice President of Pension and Benefit Investments for RJR Nabisco, and similar service for the Bell Atlantic Corporation and several of its predecessor corporations. His significant experience was a tremendous asset, especially in the formative years of the Trust.

At the time of this search, the Board also sought advice from Russell Reynolds with respect to the appropriate level of compensation for a qualified individual to serve as the Independent Trustee. Based on this advice, the Board set Mr. MacMurray's compensation. Once again, as is explained more fully above with respect to our comment on staff compensation, the Inspector General's memorandum incorrectly states the aggregate compensation paid to Mr. MacMurray. The Internal Revenue Service changed its reporting requirements for the FY2008 Form 990 in such a way that resulted in most of the compensation that had been reported in NRRIT's Form 990 for FY2007 also being included in the Trust's FY2008 Form 990. By simply adding the totals of the two years, the Inspector General has double counted a significant amount of compensation and distorted the aggregate numbers.

Mr. MacMurray's compensation remained unchanged from the beginning of his service on the Board until 2006, when the other six Trustees determined that his compensation should be increased to a level more commensurate with his overall contribution to the work of the Board. Not only had Mr. MacMurray dedicated far more time to Trust matters, and undertaken more complex assignments than initially had been contemplated, but the Trustees also noted that Mr. MacMurray was about to assume the responsibility of Chair of the Audit Committee. Mr. MacMurray's contribution to NRRIT cannot be measured simply by tabulated reference to Board meetings or conference calls. He was tireless in his devotion to his work. He regularly prepared thoughtful analyses for his fellow Board members on topics including: investment trends in the

industry; potential implications of changes in the Trust's asset allocation or over- or under-weightings within that allocation; statistical analysis of Trust asset performance, including assessment of that performance against peers; and industry recruitment and compensation trends. During his tenure, Mr. MacMurray served actively on both the Trust's Audit Committee and Administrative Committee. Before many Board meetings, he would come to Washington early to meet with staff to review, informally, their thinking on developments and trends within their asset class responsibilities, and would share insights gleaned from these sessions with other members of the Board.

Mr. MacMurray's responsibilities did not generate any conflict of interest or trustee independence concerns, as alleged by the Inspector General's memorandum, due to some presumed overlap between his responsibilities and those of the staff. While Mr. MacMurray and his breadth of experience provided tremendous value to NRRIT's investment staff, his role was always to provide advice and counsel to the Board. Just as his thoughtful analyses helped bring insight to Trustees on a number of matters that were subject to Board decision, they also helped the staff view things from various perspectives as they went about their day to day work.

Lastly, the Inspector General's memorandum is incorrect in stating that board members, such as Mr. MacMurray, generally are expected to serve without compensation. The report cited was prepared by a panel that provides recommendations for Congress to improve the oversight and governance of charitable organizations and for individual nonprofit organizations to ensure high standards of ethics and accountability. NRRIT is not a charitable organization. It is a large investment trust with more than \$20 billion in assets under management. Its Board is statutorily required to appoint a qualified Independent Trustee who has experience and expertise in the management of financial investments and pension plans to assist in the governance of this significant enterprise. That is exactly what the Trust did when the Board made the decision to retain Mr. MacMurray to be its first Independent Trustee.

The decision to retain Mr. MacMurray as the Independent Trustee in 2002 was one of the key initial decisions made by the Board of this then start-up organization. Every Trustee who served with Mr. MacMurray during his nine years on the Board agrees that it was one of the best decisions the Board has made. To acknowledge his very important contribution, the Trust's Annual Management Report for FY2011 was dedicated to Mr. MacMurray.

4. Administrative Expenses

IG Concern: *The IG memorandum criticizes the continued growth of administrative expenses and notes that more than 90% of the administrative expenses are investment management fees, compensation, and professional fees, but that explanatory material to justify these expenses is not being sent to the RRB and constitutes a lack of financial transparency.*

Investment Staff. As the Trust portfolio has been transitioned from passive management at the beginning in FY2002 and FY2003 to a significantly higher level of active management today, the portfolio has become considerably more complex and has required the commitment of a higher level of resources. This complexity resulted in the expansion of the investment staff from one person in 2002 to 20 in 2007 in order to recruit the expertise needed to prudently manage the asset classes in the Trust's Investment Plan. With staffing now built out, the size of

the staff has stabilized and remained between 17 and 20 over the past five years.

Investment Manager Fees. As active managers were identified and retained to build out the Trust's strategy pursuant to its Investment Plan, investment management fees increased due to the higher cost of active management compared with indexing. In FY2003 all of the Trust's assets were in passive index investments. Today, more than 75% of Trust assets are under active management. While the investment manager fees for active management are higher, the investment performance of such active management is also expected to be stronger. Since investment returns of all managers are calculated and evaluated on a net-of-fee basis, the impact of higher active manager fees are assessed automatically in the context of the evaluation of investment performance. Care is taken in the negotiation of all investment manager contracts to provide NRRIT with as favorable terms as are being made available to any other similarly situated investor. The investment staff meets regularly with all of the asset managers who manage Trust assets. Part of this oversight process for managers with assets in a separate account is an assessment of fees, to see where additional savings might be negotiated. Higher investment fees and greater complexity also result from the use of alternative investments such as private equity, real estate, and energy partnerships, and absolute return strategies. While these types of investments have higher fees and typically are less liquid, the higher rates of return expected from such alternative investments makes it prudent to maintain an allocation to them in the Trust's Investment Plan. Fees for such limited partnership investments typically are less subject to negotiation, but returns for these investments also are evaluated on a net-of-fees basis.

Professional Fees. Professional fees reflect the increased complexity of the Trust's investment structure and the increased number of investments in the alternative investment asset classes. For example, in 2004, the first five alternative investment transactions were entered into. In 2011, the number of such transactions entered into just in that year had increased to 24. As the number of alternative investment partnerships with complex legal structures has grown, the legal costs of reviewing these proposed investment structures has increased as well. In addition, audit fees similarly have increased as the Trust portfolio has become more complex. More rigid accounting standards for valuing assets held in these less liquid alternative investments often present more complicated and time consuming valuation questions for the Trust's auditors.

To manage these issues that come with the growth in the complexity of the overall portfolio, the Trust has taken steps in recent years to negotiate rate reductions for all legal work, established fixed budgets for regular legal work, and budget caps for legal review of individual investment partnership transactions. Also, in 2012, the Audit Committee undertook a review of audit costs for the statutorily required annual audit and the second audit required by the RRB in conjunction with its preparation of its Statement of Social Insurance. As a result of this review, fees for the aggregate work on these audits have been reduced through efficiencies gained from better coordination of auditor resources devoted to the separate audits.

The NRRIT Board takes very seriously its fiduciary responsibility to manage prudently the assets held by the Trust. Prudent management requires the engagement of competent, experienced professionals, both for our in-house investment staff and with the managers that we

Mr. Karl T. Blank
September 11, 2012
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select. Prudent management also requires careful control of expenses to maximize the net return on assets of the Trust. We carefully weigh both of those responsibilities in every decision that we make.

We believe that as a percentage of assets under management, our fees are relatively low compared to other similar investment entities. As noted in a report of the Congressional Research Service on the Trust in 2011:

“The Trust’s administrative expenses have steadily increased as its investment portfolio has diversified over time.... However, administrative expenses remain low compared with industry standards. In FY2010, the Trust’s expense ratio was 33 basis points (expenses were 0.33% of average net assets). In comparison, in 2010, the average expense ratio for all investors was 95 basis points for stock funds, 72 basis points for bond funds, and 26 basis points for money market funds.”

While we view this report as some validation of our and NRRIT staff’s efforts to maintain relatively low administrative costs while continually seeking to grow Trust assets, we will continue to seek additional efficiencies wherever available.

Please let us know if you have any questions about these issues.

Sincerely,

A handwritten signature in cursive script that reads "William F. Quinn".

William F. Quinn
Chair





UNITED STATES GOVERNMENT
MEMORANDUM

FORM G-115f (1-92)
RAILROAD RETIREMENT BOARD

October 4, 2012
L-2012-35

TO : The Board

FROM : Karl T. Blank *Karl T. Blank*
General Counsel

SUBJECT : Oversight by the Railroad Retirement Board of the National
Railroad Retirement Investment Trust

This is in reply to your request that I review the memorandum from the Inspector General of the Railroad Retirement Board to Chairman Michael S. Schwartz dated August 30, 2012, and provide you my opinion as to any necessary action the Board should take. The Inspector General's memorandum questions the degree of oversight which the Railroad Retirement Board (RRB) exercised over the staff compensation and administrative expenses of the National Railroad Retirement Investment Trust (the Trust). As explained in the following analysis, the law limits the decisions and actions of the Trust which are subject to oversight by the RRB. In view of the response to the Inspector General's memorandum which the Chairman of the Trust provided to me by letter dated September 11, 2012, (copy attached) in my opinion the Board need not take further action regarding the compensation and expense issues.

The limitations with respect to RRB control of the Trust are evident from both the structure of the Trust itself, and in the structure and interplay of the provisions of law governing its authorities and duties. At the outset, the Trust is established by section 15(j) of the Railroad Retirement Act of 1974, as amended (45 U.S.C. § 231n(j)). That section provides that, unlike the RRB, the Trust is not a department, agency or instrumentality of the Government of the United States. The seven member Board of Trustees is comprised of three members selected by joint

recommendation of national rail labor organizations organized in accordance with the Railway Labor Act; three members selected by joint recommendation of rail carriers, and an independent member selected by majority vote of the six labor and carrier members. No Trustee may also be a Member of the Railroad Retirement Board.

The legislative history demonstrates that the independence of the Trustees from the Railroad Retirement Board is no mere afterthought or scrivener's error. Congress added section 15(j) to the RRA by section 105 of Public Law 107-90, the Railroad Retirement and Survivors' Improvement Act of 2001 (118 Stat. 878, 882-87). The various provisions of the 2001 law, including the amendment to section 15 of the RRA, arose from rail labor and management negotiations, and were first introduced to the 107th Congress in 2000 as House Bill 4844. That Bill would have provided for appointment and removal of each of the seven Trustees "by a unanimous vote of the Railroad Retirement Board". See 146 Cong. Rec. H7335, 7336 (Sept. 7, 2000)(setting forth section 105(a) of the bill). After the Senate failed to act on HR 4844, the House retained this formula for selection and removal when the proposals were re-introduced the next year as House Bill 1140. See H. R. Rep. No. 82, Part 1, 107th Cong., 1st Sess. 5 (May 24, 2001). However, when considered for passage, the present language providing direct selection by rail labor and management had been substituted. See 147 Cong. Rec. H4955, 4956 (July 31, 2001). Representative Don Young of Alaska noted at that time that the substitution was made "To address concerns about protecting the investment of tier 2 pension assets from possible influence by the Federal Government". Ibid., at H4959. The present language appeared again in House Bill 10, which was ultimately enacted into law. See 147 Cong. Rec. H9160 (December 11, 2001). Clearly, Congress' reorientation of Trustee selection away from control by the RRB Board Members delineates the bright line drawn between the RRB and the management decisions of the Trust regarding funds in its care.

Management structure aside, the broad powers and duties of the Board of Trustees further demonstrate the independence of the Trust from the RRB. As set forth in 15(j)(4), the primary duties of the Trust are to invest assets of the Trust in a manner consistent with such investment guidelines, either directly or through the retention of independent investment managers; and to transfer money from the assets of the Trust to the disbursing agent to pay benefits under the RRA. Insofar as is relevant to the Inspector General's memorandum, with respect to internal operations, the

Act allows the Trust to retain independent advisers to assist it in the formulation and adoption of its investment guidelines. The Trust is directed to employ professional staff, and contract with outside advisers, who will provide legal, accounting, investment advisory or management services or other services necessary for the proper administration of the Trust. Compensation for these services must be on a fixed contract fee basis, or on such other terms as are customary for such services. That section further grants the Trust general authority to conduct business, to carry on operations, to exercise its powers within or without the District of Columbia, to form, own, or participate in entities of any kind, to enter into contracts and agreements necessary to carry out its business purposes, to sue and be sued, and to possess and exercise any other powers appropriate to carry out the purposes of the Trust. Administrative expenses incurred in these activities must be paid from the assets of the Trust.

Section 15(j)(5) of the RRA imposes on the Trust and Trust Board Members the duty to discharge the foregoing authorities solely in the interest of the Railroad Retirement Board and through it, the participants and beneficiaries of the programs funded under RRA. Thus, the Trust and Trustees are specifically charged to act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”. In addition to Trust governing documents and other instruments consistent with the RRA, section 15(j)(5) specifies these aims as providing benefits to participants and their beneficiaries; defraying reasonable expenses of administering the functions of the Trust; and diversifying investments so as to minimize the risk of large losses and to avoid disproportionate influence over a particular industry or firm, unless under the circumstances it is clearly prudent not to do so.

In execution of the foregoing duties, section 15(j)(5)(E) of the RRA imposes a specific requirement on the Trust to engage an independent public accountant to provide an annual audit of the financial statements of the Trust. That section also requires the Trust provide the President, Congress, the Director of the Office of Management and Budget with an annual management report which includes:

- (I) a statement of financial position;
- (II) a statement of operations;
- (III) a statement of cash flows;

(IV) a statement on internal accounting and administrative control systems;

(V) the report resulting from an audit of the financial statements of the Trust conducted under clause (i); and

(VI) any other comments and information necessary to inform the Congress about the operations and financial condition of the Trust.

The May 2001 House Report on H.R. 1140 explained that Trustees would be subject to reporting and fiduciary standards parallel to the requirements imposed on fiduciaries of private employer pension benefit plans under the Employee Retirement Income Security Act. The Report then enumerated the duties set forth by section 15(j)(5)(A) of the RRA. See: H. R. Rep. No. 107-82, supra, at 20. Later, when the Senate considered passage of H.R. 10, Senator Max Baucus of Montana answered criticism that the amendments jeopardized long-term solvency of the railroad retirement system by specifically referring to the independent audit and reporting requirements:

* * * this legislation before us has lots of built-in sort of requirements of independent audits, of reports, and looking far ahead as possible to try to anticipate if there is going to be a problem of some kind or other.

Specifically, the legislation before us requires the trust fund to have an independent, qualified public accountant to audit the trust. The trust fund then must submit a report to Congress which includes a report based on the audit. The report must contain financial statements of operations and cashflow. 147 Cong. Rec. S12354 (December 4, 2001).

It is noteworthy that neither House Report 107-82 nor Senator Baucus mention audit oversight by the RRB as a control over the Trust. Rather, in contrast to the lengthy requirements imposed upon the Trust, section 15(j) provides only that the RRB may bring a civil action to enjoin any act or practice by the Trust, its Board of Trustees, or its employees or agents which violates the RRA; or to obtain other appropriate relief to redress such violations, or to enforce any RRA provisions.

Provisions of a law are to be read together to determine their meaning. Reading together the various paragraphs of RRA section 15(j) which remove RRB influence

from Trustee selection, which specify at length the fiduciary and reporting duties of the Trust, and which specify a single means of enforcement by the RRB of these standards and duties, clearly demonstrates that Congress expected the reporting and enforcement provisions to operate together, along the model of private plans subject to the fiduciary provisions of ERISA. In my opinion, applying ERISA standards to the information provided by the September 11 response by the Chairman of the Trust to the Inspector General's August 30 memorandum fails to demonstrate a basis for civil action by the Board under RRA section 15(j) against the Trustees.

Attachment

Handwritten signature of KTB in black ink.

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