TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Role of Fiduciary Counsel ITEM NUMBER: 6

ATTACHMENT(S): 1

ACTION: ____ DATE OF MEETING: July 9, 1998

INFORMATION: X PRESENTER(S): Mr. Waddell

As the Board has been previously advised, the purpose of this agenda item is to revisit the manner in which STRS has used fiduciary counsel, consistent with the need identified during the Cortex governance process to review, modify and document the role of such counsel to ensure that counsel plays a "distinct, meaningful, and clearly understood role." To that end, we are providing the Board with information pertaining to the history of the Board's use of fiduciary counsel, the current Board policy concerning the use of fiduciary counsel, and a statement of the issues that the Board should consider in determining whether it should change its current policy and what those changes, if any, should be.

To assist the Board further in its consideration of the matter, Ms. Nancy Williams of William M. Mercer will make a presentation concerning the available models for use of fiduciary counsel of a retirement system and the practices of other large public pension plans in this area. Ms. Williams is Mercer's National Public Sector Practice Leader, specializing in fiduciary responsibility, policy development, strategic planning, benchmarking, re-engineering, legislative programs, and benefit designs for public retirement systems. Prior to joining Mercer, she served as Deputy Executive Director and General Counsel of the Public Employees' Retirement Association of Colorado and General Counsel to the State Teachers' Retirement System of Ohio.

Historical Role and Use of Fiduciary Counsel at STRS

STRS has retained Ian Lanoff as fiduciary counsel since 1984. As of this writing, we have not been able to unearth any Board records from that timeframe that would document specifically the reasons for this action. However, it is generally acknowledged that there were at least three factors involved in the Board's decision. First was the controversy concerning the Board's TXPACCO investment and the desire to avoid repeating that experience. Second was the then-recent split of the investment functions of PERS and STRS, which had for the first time left the STRS Board responsible for the investment function. Third, there had been significant turnover in key positions at the System, with a resulting loss in continuity of leadership of the organization.

The tie between the TXPACCO investment and the hiring of fiduciary counsel was clearly expressed by former Chief Executive Officer Larry Kurmel, who, in a 1987 letter to a System member who had inquired about what steps had been taken to avoid a repeat of the TXPACCO situation, stated that:

> "… The System employs a fiduciary counsel to attend meetings. This counsel represents the Fund and its beneficiaries; not the Board. His job is to make sure that "due diligence" is exercised in all matters brought before the Board."

In addition to setting forth one of the historical bases for retaining fiduciary counsel, the above statement also demonstrates what has proven to be a recurring theme in the Board's consideration of fiduciary counsel – that the purpose of such counsel is not to advise and/or represent the Board, per se, but to represent the interests of the System and its members and beneficiaries. This view of the role of fiduciary counsel was reaffirmed by Larry Boulger in a memorandum to the Board dated February 22, 1995, which states that:

> "The Fiduciary Counsel does not as such represent the Board. The position presents a unique perspective in the relationship between attorney and client because Fiduciary Counsel presents to the Board the legal position of the members, retirants and beneficiaries of the fund. It should be understood that in some situations there may be no attorney/client privilege with respect to the communications between the Board and the Fiduciary Counsel because the "true client" is the one who pays the bills, i.e. the members, retirants and beneficiaries."

To our knowledge, this is a unique use of outside fiduciary counsel. It should be noted, however, that a more traditional role of fiduciary counsel has also been described. For example, in a 1990 agenda item before the Board concerning the fiduciary counsel selection process, the Chief Executive Officer stated that:

> "The primary function of the fiduciary counsel is to provide <u>the Board</u> with Legal advice as to whether it is properly discharging its fiduciary responsibility." (Emphasis added).

This view of the role of fiduciary counsel is also found in various Board records throughout the years. Simply put, however, we have not found a definite statement that the Board has selected one role over the other, and it might be concluded that the status quo involves both roles. As such, it is not surprising that from time to time there has been uncertainty regarding the role of fiduciary counsel in a given situation.

Current Board Policy Concerning Fiduciary Counsel

The current Board policy regarding fiduciary counsel, adopted on September 15, 1989, does not on its face incorporate the role of fiduciary counsel as counsel to members, retirees and beneficiaries of STRS. Rather, it states that:

> "The Teacher's Retirement Board (Board) recognizes the need for the specialized advice of a fiduciary counsel to assist the Board in discharging its fiduciary responsibilities. (Emphasis added).

Current Board policy also provides that fiduciary counsel:

> "…shall attend all regular Investment Committee meetings unless otherwise directed by the CEO".

The attendance by fiduciary counsel at all regular Investment Committee meetings has also been reviewed by the Board from time to time. Minutes from the Investment Committee meetings of May 6, 1988, reflect that Professor Schotland from Georgetown Law School gave a presentation on the role of fiduciary counsel. He opined, in part, that while it was important for the System to have both in-house counsel and outside fiduciary counsel, not all fiduciary matters warranted the involvement of fiduciary counsel. He further opined that it should not be necessary for fiduciary counsel to attend all meetings, so long as fiduciary counsel reviewed the agenda materials for an upcoming meeting, discussed the need for his or her attendance at the meeting with in-house counsel and appropriate staff, and had alternative means of providing input (e.g., written submission; telephone availability) to the Board on a given issue.

It appears from subsequent Board records that Professor Schotland's suggestion that there be a monthly determination made regarding the need for attendance of fiduciary counsel at Board meetings was implemented, but was discontinued after a few months as to Investment Committee meetings because it became apparent to staff that fiduciary counsel would, as a practical matter, be attending all such meetings.

In summary, written Board policy reflects a more traditional role of outside fiduciary counsel as counsel to the Board. However, as noted previously, more than five years after that policy was adopted, the Legal Office continued to express the view that fiduciary counsel represents not the Board per se but the members, retirees and beneficiaries. Further, while the issue of whether to continue the attendance by fiduciary counsel at all Investment Committee meetings has been considered by the Board in the past, no permanent changes in this practice have been implemented.

Issues for the Board to Consider

The purpose of the above information and the presentation by Ms. Williams is to stimulate discussion by and questions from the Board regarding the future role to be played by fiduciary counsel. In its consideration of this matter, the Board may wish to address the following questions:

1) Should the Board revise or clarify its existing policy on the use of fiduciary counsel?

2) Does the Board wish to specify that the attorney-client relationship is between fiduciary counsel and the Board; or, conversely, between fiduciary counsel and members, retirees and beneficiaries.

3) Should fiduciary counsel continue to attend all Investment Committee meetings? If not, what should the criteria be for attendance?

4) How should fiduciary counsel be selected?

5) Who should make the decision to engage fiduciary counsel on a particular issue?

6) Should fiduciary counsel report directly to the Board or through the Chief Counsel?

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The Teachers' Retirement Board (Board) recognizes the need for the specialized advice of a fiduciary counsel to assist the Board in discharging its fiduciary responsibilities. The Fiduciary Counsel will focus on the investment and benefits responsibilities of the Board to include, but not be limited to, the monitoring of other counsel the Board contracts with to provide specialized litigation services. Additionally, the Board directs the Chief Executive Officer (CEO) to contract for the fiduciary counsel services described above; and further directs the CEO to approve all uses of the fiduciary counsel.

Subject to the determination of the CEO and the limitations set forth above, the fiduciary counsel contract will include provisions for the following:

1. Inclusion of a process that requires an estimate of costs and CEO approval prior to any billable hours. The contract shall provide that advice given to individual members will be reported to the Investment Committee or Board at the next meeting the fiduciary counsel attends.
2. Fiduciary counsel shall attend all regular Investment Committee meetings unless otherwise directed by the CEO. Attendance at other meetings, including special meetings, will be as directed by the CEO. Attendance at and preparation for all meetings will be subject to the prior approval process as set forth in paragraph 1.
3. Fiduciary counsel will evaluate and monitor litigation directly affecting the investment of the Fund as it is conducted, but will not be a candidate for litigation services.
4. Fiduciary counsel will be assigned the drafting of legal opinions and the review of written materials such as policy manuals as determined by the CEO.
5. The contract will include a 30-day termination clause.
6. The contract will provide a conflict of interest prohibition and reporting procedure pursuant to the California Political Reform Act.

Adopted by Teachers' Retirement Board on: September 15, 1989
Public Contracts Code Reference: 10355