

FIDUCIARY SCENARIOS: CAN YOU SPOT THE ISSUES?

Presentation to the Board of Commissioners
Los Angeles Fire and Police Pensions

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FUNDAMENTAL FIDUCIARY DUTIES OF LAFPP COMMISSIONERS

- Primary Loyalty Rule
- Exclusive Benefit Rule
- Prudent Investor Rule
- Follow the Law

INVESTMENT SCENARIO

You are at LAX on your way to an investor conference and you run into the client relations officer of a global tactical asset fund. You sit together on the plane and at one point you confess that you really don't understand "derivatives." She gives you a very informative primer, for which you are grateful.

(Any issues so far?)

During the flight, she mentions that they have a new investment opportunity - Bolivian currency hedging - and asks you get them an audience with the Board quickly, since a "window of opportunity" is closing and you don't want to lose out. You tell her this is great news, since the market has really hurt LAFPP's funding and you're looking for quick "alpha"!

(Any issues yet?)

You graciously agree to help put the matter on the next Board agenda, and also to push the Board to bypass the cumbersome RFP process and do a direct engagement.

(Issues?)

A week before the meeting, she calls you just to say "hi." You suggest bringing 2 other Board members to lunch with her so she can answer any questions they might have before the Board vote. (This way nobody has to ask embarrassing questions in public.)

At lunch, she tells you that if LAFPP invests \$100 million the LLC will funnel the money into the manager's publicly traded fund that hedges Bolivian currency.

(Issues?)

In that same conversation, she tells you that she is making a \$1,000 contribution to the Mayor's reelection campaign, in your honor. You are delighted!

(Issues?)

When the next Board agenda gets posted, Investment Staff asks you about the proposal. You tell them "don't worry, I've done all the due diligence and it's all fine...trust me on this one."

(Issues?)

The day before the Board meeting, you tell the broker who manages your personal 401(k) account that you want him to sell every position and put it all into shares of a certain publicly traded Bolivian fund, because you have a sense it's "really gonna take off soon!"

(Any issues here?)

The same day, one of the Board members who came to lunch explains to two other Board members what the agenda item is all about and what a great deal it is... they should vote for it.

(Issues?)

At the Board meeting, nine members are present and voting. You make a motion to approve the investment. One Board member objects that the usual RFP process was not followed. You accuse her of dithering over technicalities when there is money to be made! You call for the question. The vote is 6-3 in favor.

(Issues?)

You call the client rep and give her the good news. She's delighted and invites you to fly with her to Indianapolis on the company jet to see the Super Bowl, and you have the best porterhouse steak you've ever had, with a magnum of 1928 Chateau Margaux. On the way home, you think, "maybe this job isn't so bad after all!"

(Issues?)

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GOVERNANCE SCENARIO

You are an appointed Board member.
You get a call from the Mayor who asks
you to come by to talk.

(Any issue...yet?)

You go to see the Mayor and are told that she wants to discuss LAFPP's funding; she's "not happy with the pension board's actions that keep increasing the cost to the City."

(Any issues?)

She says she wants you to make a motion to move the assumed earnings rate back up to 8% when the matter comes up on the next agenda.

(Issues?)

She says she's spoken with all the other appointed Commissioners and they are all on board with this plan.

(Issues?)

She says she's also spoken with two active elected members and they, too, are on board, because otherwise she'll trigger county-wide layoffs and have them reassigned, "and you know I can!"

(Any problems here?)

She also says that if you'll "carry this one for me," she'll put in a good word for you on that new county software contract that your company is bidding on.

(Any problems here?)

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ALWAYS ASK YOURSELF:

- Am I acting independently?
- Am I acting only for the benefit of the system and its members?
- Do I have a personal financial interest in this matter?
- Am I acting prudently?
- Do I have all the information I should have?
If not, ask staff!

THE FUNDAMENTAL FIDUCIARY DUTIES OF LAFPP COMMISSIONERS

CALIFORNIA CONSTITUTION, ART. XVI, § 17

1. Primary Loyalty Rule

The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

2. Exclusive Benefit Rule

The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

3. Prudent Person Rule/Duty to Diversify Investments

The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims....[They] shall diversify the investments of the system so as to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

LOS ANGELES CITY CHARTER, SECTION 1106

Consistent with Article XVI, Section 17 of the California Constitution...each pension and retirement board of the City shall:

(a) Administration of the Pension or Retirement System. Have sole and exclusive responsibility to administer its system for the following purposes:

- (1) to provide benefits to system participants and their beneficiaries and to assure prompt delivery of those benefits and related services;
- (2) to minimize City contributions; and
- (3) to defray the reasonable expenses of administering the system.

The duty to system participants and their beneficiaries shall take precedence over any other duty.

(b) Assets. Have sole and exclusive fiduciary responsibility over the assets of its system which are held in trust for the exclusive purposes of:

- (1) providing benefits to system participants and their beneficiaries; and
- (2) defraying the reasonable expenses of administering the system.

(c) Prudent Person Standard. Discharge its duties with respect to its system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) Investments. Diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

THE LAWS, RULES, REGULATIONS AND POLICIES THAT IMPACT THE FIDUCIARY DUTIES OF LAFPP COMMISSIONERS

- CALIFORNIA CONSTITUTION, ARTICLE XVI, SECTION 17
- LOS ANGELES CITY CHARTER, SECTION 1106
- POLITICAL REFORM ACT AND RELATED FPPC RULES AND REGULATIONS
- PUBLIC RECORDS ACT
- RALPH M. BROWN ACT (“OPEN MEETINGS LAW”)
- CALIFORNIA GOVERNMENT CODE SECTIONS 7501, ET SEQ.
- CALIFORNIA GOVERNMENT CODE SECTIONS 1090, ET. SEQ.
- CALIFORNIA LABOR CODE
- INTERNAL REVENUE CODE AND RELATED IRS RULES AND REGULATIONS
- SECURITIES EXCHANGE ACTS AND RELATED SEC RULES AND REGULATIONS
- LOS ANGELES CITY CODES AND ORDINANCES
- LAFPP’S BY-LAWS, CHARTERS AND POLICIES