



Agenda Item 11

October 15, 2014

ITEM NAME: Fiduciary Counsel – Finalist Interviews and Selection

PROGRAM: Board of Administration

ITEM TYPE: Action

RECOMMENDATION

Interview the three Finalists selected by the Board at its August 2014 meeting and select the firm or firms to be awarded contracts to serve as CalPERS' external fiduciary counsel.

EXECUTIVE SUMMARY

The purpose of this item is to provide the Board with information about the Finalists selected for interview by the Board, and for the Board to interview these Finalists and select the firm or firms to be awarded contracts to serve as CalPERS' external fiduciary counsel.

STRATEGIC PLAN

This agenda item supports Goals A and B of the 2012-2017 Strategic Plan in seeking to improve long-term pension and health benefit sustainability, and in cultivating a high-performing, risk-intelligent and innovating organization.

BACKGROUND

CalPERS' History of Retaining External Fiduciary Counsel

The Board has reserved the power to select CalPERS' external fiduciary counsel, and has retained external fiduciary counsel since at least 1990. Historically, fiduciary counsel has advised the Board and staff on a variety of issues involving fiduciary liability and responsibility. These issues have focused on the Board's and staff's fiduciary duty to CalPERS' members and issues involving the application of California Constitution article XVI, section 17 (as amended in 1992 by voter initiative Proposition 162) and other trust law principles to various situations. CalPERS has retained external fiduciary counsel to provide advice in many areas, including but not limited to, vested rights issues, the appropriate and prudent use of trust funds to administer the System, and issues arising from delegation and oversight responsibilities including trustees' responsibilities when restructuring or revising actuarial or funding policies and when considering economically-targeted investments, divestment and social investments. CalPERS' external fiduciary counsel respond to requests for legal opinions and advice from the CalPERS Board

and staff, directed through CalPERS' General Counsel. In-house counsel provide technical assistance, serve as liaison to CalPERS' staff, and monitor outside counsel billing practices and responsiveness to client needs. CalPERS pays outside counsel for actual work performed, in arrears, subject to annual contract maximums.

Over the years, the manner and types of services performed for CalPERS by fiduciary counsel has varied. Years ago, external fiduciary counsel reviewed all Board and Committee agenda materials and regularly attended Board and Committee meetings. More recently, external fiduciary counsel has rarely attended meetings but has been called on periodically to advise the Board with respect to very specific issues. External fiduciary counsel has also traditionally participated in presenting the Board's annual fiduciary duty workshop.

The Board last selected external fiduciary counsel in November 2010. The firms selected were Reed Smith LLP and Reinhart Boerner Van Deuren S.C. Their contracts expire on December 31, 2014. The objective of this agenda item is for the Board to select external fiduciary counsel and to have contracts in place by January 1, 2015.

Reasons for Retaining External Fiduciary Counsel

When the Board and staff do not themselves possess all of the expertise they need to carry out their fiduciary duty to the System's members, the Board and staff are permitted to consult with experts in the field. Just as the Investment Committee and the Investment Office staff rely on outside consultants and experts, the Board and staff may on occasion require the expert advice of external fiduciary counsel when complex fiduciary issues arise.

Fiduciary legal representation is a very specialized area of the law that is difficult to duplicate internally. Because the firms that concentrate in this area represent other public pension systems as well, they are able to provide a more comprehensive perspective than can the Legal Office. In addition, they provide an independent opinion on fiduciary matters that can be particularly helpful on controversial issues.

All public pension systems with which staff has spoken employ external fiduciary counsel. Accordingly, the retention of external fiduciary counsel appears to be the "industry norm" or a "best practice." CalPERS would likely be an outlier if it did not retain external fiduciary counsel.

Legal Services Contracts are Exempt from Competitive Bidding Requirements

Contracts for legal services are handled differently from other CalPERS contracts because they are exempt from competitive bidding requirements under California law (Cal. Public Contract Code section 10335.5). Despite this exemption, CalPERS has historically requested proposals from potential candidates to encourage competition

among firms, to obtain competitive pricing of legal services, and to create a diverse pool of providers. Pursuant to the terms of CalPERS' standard solicitations for legal services, selections are based on an evaluation of written proposals and interviews, with no formal scoring of the proposals. In most solicitations for legal services, Legal Office staff evaluates written proposals and conducts interviews to select outside counsel in various legal specialties. However, in the case of CalPERS' external fiduciary counsel, the Board has reserved for itself the authority to select the firm or firms to serve in this capacity.

This Solicitation

CalPERS released a solicitation for these services in March 2014 (Solicitation). A copy of the Solicitation is included as Attachment A. Ten firms submitted proposals. CalPERS' staff evaluated the proposals and interviewed five of the submitting firms. The interview panel consisted of the Chief Executive Officer, Chief Financial Officer, General Counsel, Deputy General Counsel and Senior Investment Officer for Real Estate.

At the conclusion of the interviews, the panel evaluated the five firms based on their proposals, interviews and reference checks against the criteria included in the Solicitation. Specifically, the panel considered each firm's breadth, depth and longevity of experience providing fiduciary advice to public pensions; unique characteristics of the firm; the firm's style and approach to providing fiduciary counsel services; the firm's willingness to attend board meetings and review agenda materials in advance; the firm's enthusiasm and commitment to Board and staff training; and the firm's proposed hourly rates and willingness to consider alternative fee arrangements. Staff also considered the firms' commitment to diversity and information provided during the reference check process. Based on all of these considerations, staff recommended that the Board interview the top two candidates. At the August meeting, the Board decided instead to interview the top three candidates, Klausner Kaufman Jensen & Levinson; Reed Smith LLP; and Reinhart Boerner Van Dueren S.C.

ANALYSIS

The Board's interviews will provide an opportunity for the Board to meet the Finalists personally and ask them questions. A summary of each Finalist's proposal is included as Attachment B. A complete copy of each Finalist's proposal, a summary of staff's evaluation of the Finalists, information regarding external fiduciary counsel fees for the past three and a half years, and sample interview questions will be provided separately to the Board.

Each interview is scheduled for 30 minutes. The firms have been asked to make a presentation no longer than 10 minutes at the beginning of the interview, with the remaining 20 minutes to be used for questions and answers. As mentioned above, because contracts for legal services are exempt from state law competitive bidding

requirements, the selection of the firm or firms to be awarded contracts does not need to be based on a formal scoring procedure. Accordingly, staff recommends that instead of assigning scores to the firms following the interviews, the Board discuss the candidates and select the firm or firms to be awarded contracts.

The Board may also wish to consider and give direction to staff regarding the scope of services the Board desires from its external fiduciary counsel. As noted above, historically the services have ranged from reviewing all agenda materials and attending all Board and committee meetings to providing more project-based services.

BUDGET AND FISCAL IMPACTS

The cost for these services will vary based on the fees proposed by the firm and the services actually performed.

BENEFITS/RISKS

The benefit of engaging outside fiduciary counsel includes obtaining legal advice from firm(s) who specialize in this area of law. Aside from the fees that will be incurred in engaging outside counsel, no risks of engaging outside fiduciary counsel have been identified.

The risk of not engaging outside fiduciary counsel is that the Board and staff may not have the benefit of highly specialized expertise in connection with the primary duty of the Board and staff – the fiduciary duty to our members.

ATTACHMENTS

Attachment A – Solicitation Letter

Attachment B – Summary of Finalists' Proposals

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