

TEACHERS' RETIREMENT BOARD

BOARD EDUCATION

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SUBJECT: Conflicts/Disclosure Discussion

ITEM NUMBER: 1

CONSENT:     

ATTACHMENT(S):

ACTION:     

DATE OF MEETING: February 1, 2006

INFORMATION: X

PRESENTER(S): Chris Waddell

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**CONFLICTS, DISCLOSURES AND ETHICS: A REVIEW OF EXISTING BOARD POLICIES IN SECTION 600 OF THE BOARD POLICY MANUAL AND RELATED LAWS**

CalSTRS Board members, staff, and individuals and entities doing business with CalSTRS are subject to a multiplicity of state laws and CalSTRS policies relating to the prohibition of conflicts of interest, disclosures of potential conflicts and related matters and other ethics laws and policies. Most of these laws and policies are either summarized or set forth in their entirety in Section 600 of the Board Policy Manual, relating to ethical and fiduciary conduct.

The Board first established an Ad Hoc board governance committee in December 2004 which later drafted a charter in February 2005 indicating one of the key responsibilities of the committee was to review and make recommendations to the Board for the content of Section 500 (Board Governance), Section 600 and Section 700 (Administration) of the Board's policies. Kathleen Smalley (governance chair at the time) led the committee successfully through an updating of Sections 500 and 700. Although some discussions around conflicts policies have occurred, it was not translated into any final actions.

When the work plans for FY2005-06 were adopted by the Board in July, the Board Governance Committee once again placed this item (Section 600) for review/updating on its current calendar for the months of February and April alongside of an educational item on Conflicts for February. It should be recognized that both board members and staff have shared the view that the System has operated successfully over the past several years under these current policies; nevertheless, it was felt that in keeping with best business practices today, we should ensure that there have not been any contextual changes that would suggest improvements in any of the conflict/disclosure policies. We have all witnessed seismic shifts in the way business and regulatory bodies have viewed this critical area over the past several years. The Governance Committee's attentiveness to this area is a strong reflection on its commitment to good governance practices.

The purpose of this educational item is to walk Board members through the existing provisions of Section 600, which is included as Attachment 1 for your reference, and provide, where applicable, some discussion of what is and is not covered by existing law or policy. Following this introductory orientation, we will conduct an exercise that was originally planned for the November offsite but was not completed at that time. We are including a series of hypothetical scenarios (Attachment 2) for your review. We ask each of you to review our policies and then reflect upon each of the scenarios and identify which of our policies may cover the scenario in question. Please note the use of the word “may”—some of these scenarios involve close questions of whether the policy is applicable or not. We’re not asking you to make a conclusive determination; we are merely asking you to identify which policy or policies are potentially raised by the scenario. While this is an “open book” exam, we’re not asking you to turn in your results. Instead, please make some notes for your own use during the discussion at the education session. One caveat—not all of the policies are covered by these scenarios and some of the scenarios may implicate more than one of the policies.

This educational item is intended as a prelude to future discussions in the Board Governance Committee concerning potential revisions to Section 600.

**A. Education Code – Fiduciary Duties, Exclusive Purpose of System Assets, Prohibited Transactions, and Prohibitions Against Self-Dealing**

As Board members are aware, existing fiduciary responsibility provisions applicable to CalSTRS Board members and staff are set forth in the Education Code and are taken almost verbatim from the federal Employee Retirement Income Security Act (ERISA). In an effort to provide an easy reference for Board members to the key operative provisions that define their fiduciary responsibilities and certain prohibited conduct., we have included paraphrased versions of Sections 22250, 22251, 22252, and 22253 of the Education Code in Section 600 A of the Board Policy Manual. These sections do not include those concerned with the scope of personal liability by board members or staff in the event of a breach and other issues. Staff does not see any need for substantive amendments to Section 600 A at this time.

**B. Statement of Ethical Conduct**

Under Government Code 19990, state officers and employees shall not engage in any employment, activity, or enterprise which is clearly inconsistent, incompatible, in conflict with, or inimical to his or her duties as a state officer or employee. The law goes on to require every state body to determine those activities which are inconsistent, incompatible or in conflict with their duties as state officers or employees. The law additionally provides required elements of such any policy resulting from this determination. Section 600 B of the Board Policy Manual, entitled “Statement of Ethical Conduct,” reflects the Board policy that was adopted in response to the requirements of Section 19990 and much, but not all of the language in this section reflects

the required elements of this law. The prohibitions generally, but not exclusively, concern the use of a Board position and associated privileges for private gain. Staff believes that there may be opportunities for selective updating of Section 600 B.

### **C. Insider Trading**

In light of federal and state prohibitions against insider trading, CalSTRS has long had a policy in place that emphasizes:

- The duty to abstain from trading based on material, non public information or disclosing the information to the marketplace.
- The duty not to misappropriate information provided for a legitimate reason; and
- The duty of those who possess material, non-public information relating to a tender offer from trading in the securities of the target company.

These prohibitions are set forth in Section 600 C of the Board Policy Manual. Under this policy, “material information” is defined as that information which a reasonable shareholder would consider important in deciding how to act with respect to the security. Existing policy requires Board members and staff on an annual basis to complete a declaration which states that they have read and understood the Insider Trading Policy and agrees to comply with its requirements.

While we are not aware of any deficiencies in the current policy, staff believes that it may be useful to do some benchmarking with other public pension systems to see if there are any best practice models out there which we may want to use in updating our policy.

### **D. FPPC Rules**

As both CalSTRS Board members and staff are well aware, a plethora of provisions in the Political Reform Act affect us in the disclosure of various financial interests as well as the prohibition of participating in a governmental decision where the Board member has a financial interest. Section 600 D was included in the Board Policy Manual as a reminder to Board members of these provisions and is by no means intended as a comprehensive summary of the Political Reform Act’s provisions. Staff does not feel it would be useful to attempt a comprehensive summary but could expand the existing summary if that would be more useful.

### **E. Political Activities**

The Legislature has adopted a comprehensive set of rules governing the political activities of public officers and employees in California in Government Code Sections 3201-3209. As a reference point for Board members, we have provided a summary of these provisions in Section 600 E of the Board Policy Manual. Staff will review this summary against current law to determine if any amendments to the policy would be advisable.

**F. No Contact Policy**

Education Code Section 22364 and Board policy prohibits contact by any party financially interested in a contract from communicating with a Board member or staff during the process leading to the award of the contract. Examples of such process include, but are not limited to, Requests for Proposals (RFP) and Requests for Information (RFI), and processes related to the procurement of goods and services through the California Master Agreement Schedule (CMAS) system. The only exceptions pertain to communications that are expressly provided for as part of the procurement process and to certain incidental and/or social contacts that do not involve CalSTRS or its business. An applicant or bidder that “knowingly” participates in a prohibited communication shall be disqualified from the contract award. Board members and staff should report suspected violations immediately to the CEO.

Existing policy as reflected in Section 600 F of the Board Policy Manual still reflects the provisions of Section 22364 and do not require updating on that basis. It should be noted, however, that the not contact provisions are focused solely on vendors and do not prohibit contact by or require disclosure of communications by a Board member to staff regarding pending contracting processes at CalSTRS.

**G. Disclosure of Communications Regarding Investment Transactions**

Education Code Section 22364 goes on to provide that:

“During the evaluation of any prospective investment transaction, no party who is financially interested in the transaction, or an officer or employee of that party, may knowingly communicate with any board member concerning any matter relating to the transaction or its evaluation, unless the financially interested party discloses the content of the communication in writing addressed and submitted to the executive officer and the board prior to the board’s action on the proposed transaction.”

When disclosure is required under this provision, it must set forth the date and location of the communication and the substance of the matters discussed. Board members are under a parallel obligation to disclose such communications to the CEO and the Board prior to any Board action on a prospective transaction. The same exceptions related to certain incidental and/or social contacts described in the discussion of the “no contacts” rule are applicable to these disclosure provisions.

Existing policy reflected in Section 600 G of the Board Policy Manual still reflects the applicable provisions of Section 22364 and do not require updating on that basis. As we have previously observed, however, these provisions do not presently apply to communications with Board members regarding that transaction that is subject to staff delegation and therefore will not be

acted upon by the Board. Also, there is no provision under existing law or policy requiring disclosure of communications between Board members and staff relating to an investment transaction.

## **H. Disclosure of Contributions and Gifts**

Under Section 600 H, any person who engages in business with CalSTRS for gain or who seeks a business relationship with the System likely to generate at least \$100,000 in annual income must disclose the following types of contributions and gifts to CalSTRS Board members and staff and candidates for the offices of Controller, Treasurer, and Superintendent of Public Instruction:

- Campaign contributions in excess of \$100;
- Monetary or in kind benefits in excess of \$50, solicited for, or given to covered officers or employees;
- Charitable contributions in excess of \$50 made at the request of covered officers or employees;
- Gifts, meals or entertainment with a cumulative value equal or exceeding \$50 in any calendar year given to a covered officer or employee.

The policy provides for initial, interim, and annual disclosures and provides that violations may lead to disqualification from doing business with CalSTRS and termination of any existing business relationship.

A parallel provision in Education Code Section provides that in any matter involving a vendor or contractor in closed session there must be a written disclosure of any campaign contributions aggregating \$250 or more and any gifts aggregating \$50 or more that have been made by the vendor or contractor during the preceding calendar year to any member of the board or any officer or employee of the system.

This policy and law were enacted following a legislative investigation into claims that “pay to play” issues had arisen within the State’s retirement systems. Shortly after these hearings, CalPERS enacted a policy that would have prohibited entities doing business with CalPERS from making campaign contributions to CalPERS Board members. However, this policy was subject to an immediate legal challenge by one of the affected Board members on the ground that it was invalid as it had not been promulgated as a formal regulation pursuant to the Administrative Procedure Act. A trial court invalidated the policy. No appeal was taken from this decision and no effort was made to promulgate the policy as a formal regulation.

As written, Section 600 does not apply to the Governor or candidates for the governorship. Although the Governor is not a member of the Board, the Governor does appoint several of our Board members and consequently it may be appropriate to consider whether existing disclosure

requirements should be extended to that office. Also, current policy does not extend to candidates for the elected Board member seats as the disclosure provisions were adopted prior to the advent of elected Board members.

At the December Board meeting, several trustees commented on the availability and disclosure of campaign/gift contribution information related to Board members and the Governor. Staff will be providing the Governance Committee with such information related to the February investment transactions (both delegated and non-delegated ) items so that the Committee can make a determination as to the breadth of disclosure and format desired by the Board and staff can proceed with clear guidance for the subsequent reporting periods.

In considering the existing disclosure policies and laws, it should be noted that extensive, easily searchable campaign contribution information is obtainable on the Secretary of State's website at <http://cal-access.ss.ca.gov/>. Beyond disclosure policies, another issue for future consideration is whether from a fiduciary standpoint it is permissible for a Board member to accept a campaign contribution or gift and then vote on a matter affecting the giver of the contribution or gift. During his fiduciary education session at the November offsite, Mr. Lanoff referenced an advisory opinion from the Department of Labor which interprets provisions of ERISA regarding issue of campaign contributions received by a trustee of a pension fund subject to ERISA. Mr. Lanoff will be participating in the education session and will be prepared to further elaborate on the Department of Labor opinion and its implications for CalSTRS.

## **600 ETHICAL AND FIDUCIARY CONDUCT**

### **A. Education Code – Fiduciary Duties**

The board and its officers and employees of the system shall discharge their duties with respect to the system and the plan solely in the interest of the members and beneficiaries as follows:

1. For the exclusive purpose of the following:
  - (a) Providing benefits to members and beneficiaries.
  - (b) Defraying reasonable expenses of administering the plan.
2. With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims.
3. By diversifying the investments of the system so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
4. In accordance with the documents and instruments governing the system insofar as those documents and instruments are consistent with this part.

*Education Code Section 22250*

### **Education Code – Exclusive Purpose of Systems Assets**

- (a) Except as provided in subdivision (b), the assets of the plan shall never inure to the benefit of an employer and shall be held for the exclusive purposes of providing benefits to members and beneficiaries and defraying reasonable expenses of administering the system.
- (b) In the case of a contribution that is made by an employer by a mistake of fact, subdivision (a) shall not prohibit the return of that contribution within one year after the system knows, or should know in the ordinary course of business, that the contribution was made by a mistake of fact.

*Education Code Section 22251*

## **Education Code – Prohibited Transactions**

Except as otherwise provided by law, the board and the officers and employees of the system shall not cause the system to engage in a transaction if they know or should know that the transaction constitutes a direct or indirect:

- (a) Sale or exchange, or leasing, of any property from the system to a member or beneficiary for less than adequate consideration, or from a member or beneficiary to the system for more than adequate consideration.
- (b) Lending of money or other extension of credit from the system to a member or beneficiary without the receipt of adequate security and a reasonable rate of interest, or from a member or beneficiary with the provision of excessive security or an unreasonably high rate of interest.
- (c) Furnishing of goods, services, or facilities from the system to a member or beneficiary for less than adequate consideration, or from a member, retirant, or beneficiary to the system for more than adequate consideration.
- (d) Transfer to, or use by or for the benefit of, a member or beneficiary of any assets of the plan for less than adequate consideration.
- (e) Acquisition, on behalf of the system, of any employer security, real property, or loan.

*Education Code Section 22252*

## **Education Code – Prohibitions Against Self-Dealing**

The board and its officers and employees of the system shall not do any of the following:

- (a) Deal with the assets of the system in their own interest or for their own account.
- (b) In their individual or in any other capacity, act in any transaction involving the system on behalf of a party, or represent a party, whose interests are adverse to the interests of the plan or the interests of the members and beneficiaries.
- (c) Receive any consideration for their personal account from any party conducting business with the system in connection with a transaction involving the assets of the plan.

*Education Code Section 22253*

## **B. Statement of Ethical Conduct**

The California State Teachers' Retirement Board has established the following Statement of Ethical Conduct and has determined that engaging in any of the following shall constitute a breach of the Board Member's fiduciary duty to the System as provided in section 22250 of the Education Code.

No employment, activity, or enterprise shall be engaged in by any Board Member of the California State Teachers' Retirement Board, which might result in, or create the appearance of resulting in, any of the following:

1. Using the prestige or influence of the Board position for the Board Member's private gain or advantage of another.
2. Using state time, facilities, employees, equipment or supplies for the Board Member's private gain or advantage, or the private gain or advantage of another.
3. Using confidential information acquired by virtue of state activities for the Board Member's private gain or advantage of another, including, but not limited to, so-called "insider trading" as described in subsection "C", *infra*.
4. Receiving or accepting money or any other consideration from anyone other than the state for the performance of an act which the Board Member would be required or expected to render in the regular course or hours of his/her duties as a Board Member.
5. Performance of an act in other than his/her capacity as a Board Member or a Constitutional Officer knowing that such act may later be subject, directly or indirectly, to the control, inspection, review, audit, or enforcement by the Board Member or by the California State Teachers' Retirement System.
6. Receiving or accepting, directly or indirectly, any gift, including money, any service, gratuity, favor, entertainment, hospitality, loan, or any other thing of value, from anyone who is doing or is seeking to do business of any kind with the state or whose activities are regulated or controlled in any way by the state, under circumstances from which it reasonably could be substantiated that the gift was intended to influence him/her in his/her official duties or was intended as a reward for any official action on his/her part.
7. Having an ex parte communication on the merits of an administrative appeal held pursuant to section 22217 of the Education Code, with any party or their attorney until after the Board's decision is final.
8. Publishing any writing or making any statement to the media, to state administrators, legislative personnel, or members of the public which purports to represent CalSTRS' position or policy on any matter or subject, before the Board has formally adopted a policy or position on the matter or subject. This section

shall not be interpreted to preclude Board Members, as private citizens, from expressing their personal views.

Nothing in this Statement shall exempt any Board Member from applicable provisions of any other laws of this State. The standards of conduct set forth in this Statement are in addition to those prescribed in the System's Conflict of Interest Code.

*Amended May 5, 1999*

### **C. Insider Trading**

The Board is committed to the highest ethical standards and the closest adherence to the laws and regulations regarding insider trading. "Insider Trading" has been defined as trading securities on the basis of material, nonpublic information relating to those securities. Under a variety of federal and state laws and regulations, the duty not to engage in insider trading arises in the following areas: 1) The duty to abstain from trading based on material, non-public information or disclosing the information to the marketplace; 2) the duty not to misappropriate information provided for a legitimate reason; and 3) the duty of those who possess material, non-public information relating to a tender offer from trading in the securities of the target company. "Material information" is defined as that information which a reasonable shareholder would consider important in deciding how to act with respect to the security.

In order to ensure adherence with the above, all Board members and specified staff are required on an annual basis to complete a declaration which states that they have read and understood the Insider Trading Policy and agree to comply with its requirements.

*Amended May 5, 1999*

### **D. FPPC Rules**

1. All STRS Board Members are subject to the disclosure and reporting requirements of the System's Conflict of Interest (COI) Code and FPPC regulations. Any Board Member that receives a gift, honoraria, or of travel expenses (paid or reimbursed) or the actual transportation and related lodging and subsistence from any third party other than either the System or the State of California has the responsibility to determine whether the receipt of the same must be disclosed and reported under the System's COI Code and FPPC regulations. This section applies to STRS travel, as well as other travel expenses covered by the System's COI Code and FPPC regulations. (Current Board policy is that all official travel by Board Members is to be paid for by CalSTRS).
2. Receipt of any gift, honoraria, or payment of actual transportation and related lodging and subsistence or any payment or reimbursement of the same to Board Members regarding travel of any kind by third parties may subject the recipient

Board Member to disqualification from participation in making Board Policy related to the third party. It is the recipient's responsibility to make sure that he or she does not engage in any action that places himself or herself in a conflict of interest.

3. Under Government Code Section 87105, a Board member who has a financial interest in a decision of CalSTRS must do the following:
  - Publicly identify the financial interest that gives rise to the conflict;
  - Recuse themselves from discussing, voting, or attempting to use their influence to affect the outcome of a decision of the public body; and
  - Leave the room until after the discussion and vote on the item in question.

*Amended May 5, 1999*

## **E. Political Activities**

Essentially, Government Code Sections 3201-3209 provide:

1. Except as otherwise provided below, no restriction shall be placed on the political activities of a state officer or employee.
2. No one who holds, or who is seeking election or appointment to, any office or employment in a state or local agency shall, directly or indirectly, use, promise, threaten or attempt to use, any office, authority, or influence, whether then possessed or merely anticipated, to confer upon or secure for any individual person, or to aid or obstruct any individual person in securing, or to prevent any individual person from securing, any position, nomination, confirmation, promotion, or change in compensation or position, within the state or local agency, upon consideration or condition that the vote or political influence or action of such person or another shall be given or used in behalf of, or withheld from, any candidate, officer, or party, or upon any other corrupt condition or consideration. This prohibition shall apply to urging or discouraging the individual employee's action.
3. No one who holds, or who is seeking election or appointment to, any office shall, directly or indirectly, offer or arrange for any increase in compensation or salary for an employee of a state or local agency in exchange for, or a promise of, a contribution or loan to any committee controlled directly or indirectly by the person who holds, or who is seeking election or appointment to, an office.
4. A state officer or employee may solicit or receive political contribution to promote or defeat a ballot measure which affects rates of payment, hours of work, retirement, civil service, or other working conditions of state employees. However, such activity is prohibited during working hours.

*Amended May 5, 1999*

## **F. No Contact Policy**

Upon the release of any Request for Proposal (RFP), Invitation for Bid (IFB), or comparable procurement vehicle for any System service or product, there shall be no communication or contact between the applicant or bidder and CalSTRS Board members or staff concerning the subject of the procurement process until the process is completed.

Requests for technical clarification regarding the procurement process itself are permissible and must be directed to the System's Contracts Office.

Incidental contact between a prospective bidder or its representative and CalSTRS Board members and staff which is exclusively social, or which clearly pertains to a matter not related to the subject procurement process, is permissible.

Any applicant or bidder who willfully violates this policy will be disqualified from any further consideration to provide the applicable service or product.

Board members and staff should report any suspected violation of this policy to the Chief Executive Officer who shall determine the appropriate course of action.

*Effective: January 8, 1998*

## **G. Disclosure of Communications Regarding Investment Transactions**

During the evaluation of any prospective investment transaction, no party who is financially interested in the transaction, or an officer or employee of that party, may knowingly communicate with any board member concerning any matter relating to the transaction or its evaluation, unless the financially interested party discloses the content of the communication in a writing addressed and submitted to the executive officer and the Board prior to the Board's action on the prospective transaction. This shall not apply to communications that: (1) are part of a noticed board meeting; (2) are incidental, exclusively social, and do not involve the system or its business, or the Board or staff member's role as a system official; or (3) do not involve the system or its business and that are within the scope of the Board or staff member's private business or public office wholly unrelated to the system.

- (a) The writing shall disclose the date and location of the communication, and the substance of the matters discussed. It shall be submitted no later than five working days prior to the noticed Board meeting at which the investment transaction is being considered unless the communication occurs less than five working days before the noticed Board meeting, in which case the writing shall be submitted immediately after the communication occurs.
- (b) Consistent with its fiduciary duties, the Board shall determine the appropriate remedy for any knowing failure of a financially interested party to comply with this policy, including, but not limited to, outright rejection of the prospective

investment transaction, reduction in fee income, or any other sanction.

Any Board member who participates in a communication subject to this policy shall also have the obligation to disclose the communication to the executive officer and the Board, prior to the Board's action on the prospective transaction. The disclosure shall be in writing and shall disclose the date and location of the communication and the substance of the matters discussed. It shall be submitted no later than five working days prior to the noticed Board meeting at which the investment transaction is being considered unless the communication occurs less than five working days before the noticed Board meeting, in which case the writing shall be submitted immediately after the communication occurs. An alleged failure of a Board member to disclose communications as required herein shall be referred to the Chairperson for appropriate action unless the Chairperson is a party to the communication in question, in which case the matter shall be referred to the Vice-Chair.

The communications disclosed under this subdivision shall be made public, either at the open meeting of the board in which the transaction is considered, or if in closed session, upon public disclosure of any closed session votes concerning the investment transaction.

*Adopted January 14, 1999  
Education Code Reference 22364*

## **H. Disclosure of Contributions and Gifts**

1. Any party who "engages in business with CalSTRS for gain" shall disclose the following:
  - A. Campaign contributions as defined under the Political Reform Act, valued in excess of \$100, made to any official covered in section 2 of this policy.
  - B. Monetary or in kind benefits, valued in excess of \$50, solicited for, or given to any official covered in section 2 of this policy.
  - C. Any charitable contribution, valued in excess of \$50, made at the request of any official covered in section 2 of this policy.
  - D. Gifts, meals, or entertainment, with a cumulative value equal to or exceeding \$50, in any calendar year, given to any official covered in section 2 of this policy.
2. This policy applies to contributions and/or gifts that are made to, or on behalf of any existing CalSTRS Board member, candidates for Controller, Treasurer, and Superintendent of Public Instruction, or CalSTRS staff.
3. This policy shall apply to any vendor, investment firm, consultant, any other non-governmental entity which either (1) seeks a business relationship with the

System or (2) has a current relationship with the System, which is likely to generate at least \$100,000 annually in income, fees or other revenue to the business entity. This policy shall also apply to any business relationship with the System that will be considered in a closed session of the Board or a committee thereof.

4. Disclosure of contributions and gifts shall be required as follows:
  - A. Upon submission of an initial application or proposal to do business with the System (for the preceding 12-month period).
  - B. At the time the final decision is to be made regarding the business proposal. (To cover the interim period since the initial application.)
  - C. Annually, for the previous calendar year, if the income threshold in section 3 is met. (CalSTRS will use FPPC guidelines to determine which officials in a specific firm must file disclosure statements.)
5. Any violation of this policy may lead to disqualification from doing business with the System and termination of any existing business relationship. The Chief Executive Officer is responsible for investigating any reported violation and shall report any documented violation to the Board for action.
6. Nothing in this policy supersedes any provision of State law. Those entities engaged in business with System may also have reporting requirements under the Political Reform Act, California Government Code section 51000 et seq.

*Amended: January 14, 1999*

## **I. Fiduciary Counsel**

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. 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. Attendance by Fiduciary Counsel at Investment Committee and 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 be assigned the drafting of legal opinions and the review of written materials such as policy manuals as determined by the CEO.
4. The contract will include a 30-day termination clause.
5. The contract will provide a conflict of interest prohibition and reporting procedure pursuant to the California Political Reform Act.

*Amended May 5, 1999*

## **HYPOTHETICAL SCENARIOS**

- 1) Sally is a CalSTRS Board member and chair of the Investment Committee. She owns shares in NextBigThing (NBT), a publicly-traded company. NBT is a well-regarded company that operates in an industry that has been subject to some criticism because of its environmental practices in Far, Far Away. Unbeknownst to Sally, the Investment Office has been monitoring these industry practices with growing concern, and the Chief Investment Officer contacts her to propose placing an agenda item at an upcoming Investment Committee meeting to discuss the issue. Sally doesn't immediately draw the connection between her ownership of NBT shares and this subject matter and approves the placing of this item on the agenda. A few days later, before the Investment Committee agenda has been made public, Sally receives a call from her personal financial advisor, recommending that she sell all of her NBT holdings because they have reached the price target that they mutually set when she originally purchased the stock. During this discussion, Sally suddenly realizes that NBT is a part of the industry that is the subject of the upcoming Investment Committee meeting.
- 2) John is a partner with the law firm of Boyd, Dewey, Cheatem & Howe, which is a large law firm in Sacramento with a particularly strong real estate practice. John has been a personal friend for many years of Richard, who recently was termed out from the Legislature and has just been appointed to the CalSTRS Board. John and Richard are both avid golfers and over the years they have played in many charitable golf tournament fundraisers, each taking turns covering the entry fee for both of them. Prior to Richard's CalSTRS appointment, they had agreed to play together in a golf tournament that was a charitable fundraiser for the American Cancer Society. This was to be a particularly lavish affair at an exclusive golf course with very expensive tee prizes. It was John's turn to pay the entry fee and he had done so prior to Richard's appointment. They had a great time at the tournament and did well, each winning a new set of golf clubs. Two months later, John's firm received a Request for Proposals from CalSTRS for real estate legal services, and John submitted a proposal to CalSTRS from his firm.
- 3) The State of California, which employs a small number of CalSTRS members, owns a large piece of real estate that was originally purchased as a future freeway right-of-way but now is no longer needed for that purpose. This property is completely undeveloped and sits in the middle of a much blighted urban area. In the hope of sparking a renewal of the area, the State is soliciting proposals from developers for a large, mixed-use development that would include a mix of live/work lofts, retail, restaurants and entertainment. The State would be willing either to sell the property in its entirety to the developers or to execute a long-term lease. CalSTRS' real estate office has been approached by one of its opportunity fund partners as well as one of its joint-venture partners about whether it would invest in such an endeavor.

- 4) George has been a CalSTRS Board member for approximately six months. He is attending his first conference, which is a small, roundtable meeting of approximately 20 high-level individuals from public pension funds, investment managers, corporations, and pension consultants. One of the attendees is Will, a senior vice-president of a pension consulting firm that is a likely bidder in an RFP for pension consulting services that has just been issued by CalSTRS. George is aware of this and does not engage Will in any direct conversation. Coincidentally, however, the subject matter of the conference relates to the disclosure of financial relationships between pension consultants and broker-dealers and this is an issue that prospective bidders in the CalSTRS RFP must address. There is a spirited discussion of this topic at the conference, in which Will and George both actively participate but do not address each other directly.
- 5) Mary is the chair of the CalSTRS Benefits and Services Committee. She is reviewing the materials relating to a proposed decision that the Committee must either adopt or reject at an upcoming meeting and places a phone call to the General Counsel to get some clarification on one of the issues. Under CalSTRS policy, the General Counsel serves as counsel to the Board in benefits appeals matters. Unfortunately, the General Counsel is not available and instead she is referred to the Assistant Chief Counsel, who answers her questions. Unlike the General Counsel, the Assistant Chief Counsel is responsible for directly supervising the staff counsel who advise CalSTRS program areas on benefits appeals.
- 6) Samantha has been a CalSTRS Board member for many years. She has received an invitation to speak about public pension fund governance issues at a conference in Palm Beach, Florida. The organization sponsoring the conference has offered to pay all of her travel, lodging and meal expenses and has also offered to pay the lodging and meal expenses for Samantha's husband.
- 7) While Samantha is attending the conference, she is approached by Don, who she has known for many years. Don works for a private equity firm that has managed CalSTRS assets in the past but is not presently doing so. Don and Samantha meet for drinks and have a lengthy discussion where they catch up on family and mutual friends. During this discussion, Samantha asks Don about what is new at his firm and Don mentions that they are putting together a new buyout fund but does not get into any details about their plans. A few days after the conference, Samantha receives a call from Don, who tells her that they have completed the preliminary planning for the fund. He outlines the general parameters of the fund and advises that it will be a \$2.5 billion fund for which they will be seeking a large commitment from CalSTRS. Three months later, in reviewing the agenda for an upcoming Investment Committee meeting Samantha notices that there is an action item for the Committee in closed session relating to the approval of a \$500 million commitment by CalSTRS to Don's firm's fund.