



BEST PRACTICE

Developing a Policy to Participate in Securities Litigation Class Actions (2006) (CORBA)

Background. Public Pension Plan governing bodies (the Board) and chief administrative officers (CAO) have a fiduciary obligation to recover funds lost through investments in public securities as the result of corporate mismanagement and/or fraud. The process for recovery of such investment losses by a Public Pension Plan (Plan), or any other holder of record during the class period is through class action or individual securities litigation.

Class action is initiated when a complaint is filed with a federal court. The 1995 Private Securities Litigation Reform Act (PSLRA) requires federal courts to appoint one or more members of the putative class with the largest financial interest and willingness to serve as the lead plaintiff(s).¹ Once the lead plaintiff has been appointed all the pending legal actions are consolidated under the control of the lead plaintiff and the litigation proceeds. Every entity or individual that held stock during the class period and sustained a recognized loss from alleged securities fraud becomes a “class member” for purposes of litigation and any future settlements. In other words, Plans do not need to take any affirmative action to become a class member. However, if and when there is a settlement, a settlement administrator is appointed and gives notice of the settlement to all class members. At this time, Plans must notify the settlement administrator of their desire to participate in the court-approved settlement by filing a notice (proof of claim) by the prescribed deadline. If Plans fail to file a timely proof of claim with the settlement administrator, they will be forfeiting money rightfully due each class member.

Thus, Plans can participate in class action litigation either as lead plaintiff or as a class member through the settlement process. In most cases only larger Plans will be eligible to serve as the lead plaintiff, which requires special considerations not covered in this recommended practice. This recommended practice will focus on developing a policy to address the more common and pressing problems of monitoring a Plan’s eligibility to participate as a class member in the class action litigation and recovering losses from settlements.

Recommendation. A considerable number of Plans have not been filing proof of claim forms to

¹ See 15 U.S.C. 78u-4(a)(3)(B).

Key Entities Involved

Appointed or Elected Legal Counsel: The elected or appointed legal counsel for the plan who may have the authority to empower securities litigation counsel to pursue lead plaintiff status and/or settlement participation. This may or may not require the approval of the pension plan board.

Class Member: Entity or individual who held stock during the class period and had a loss. Class members do not have to take affirmative action until a settlement is reached.

Custodian Bank: Boards of most pension plans have a contractual relationship with a financial institution to serve as master trustee/custodian on behalf of its clients. The Custodian Bank receives notices of class action and can determine eligibility. With the consent of the Board, the Bank can then file a “proof of claim” to participate in the settlement.

General Counsel: In-house legal counsel for the Plan appointed by the Plan’s governing body and generally independent of the employer affiliated with the system (such as a city or state).

Lead Plaintiff: The petitioning entity with the largest claimed losses as a result of securities fraud designated by the court to lead a class action lawsuit. The Lead Plaintiff selects the legal counsel to prosecute the case and is influential in setting the legal fees as well as negotiating a settlement.

Securities Litigation Counsel: Firms specializing in securities law that litigate, monitor class action complaints and settlements on behalf of a Plan and evaluate the Plan’s eligibility for lead plaintiff status and/or class membership.

Settlement Administrator: Appointed by the court to notify all potential class members of the court-approved settlement and collect submitted documentary evidence of class eligibility to participate in the settlement (proof of claim). Disburses settlement to class members based on the size of their loss.

participate in settlements in which they have eligible claims and, as a result, are forfeiting money.² Therefore, the Government Finance Officers Association (GFOA) recommends that every Public Pension Plan develop and adopt a policy setting forth procedures for monitoring and participating in class action securities litigation. Such a policy should cover the issues described below.

Policy Objectives

The first component of a securities litigation policy should be an agreed upon set of objectives that the Plan intends to pursue through its participation in class action litigation which may include:

- Fulfilling the Plan's fiduciary duty by effectively managing claims as Plan assets.
- Maximizing recovery of Plan assets on claims while minimizing fees paid to obtain recoveries.

Monitoring Procedures

A Plan should develop clear, written procedures for monitoring class action litigation and settlements. Key issues to consider in designing these procedures include:

- A single person or entity (the monitor) should be assigned to monitor securities litigation and agree to established monitoring procedures. Plans may utilize internal staff; negotiate with their Custodian Bank to perform this service; or hire external securities litigation counsel or another third party claims advisory service.³
- Each class action litigation, from the time of the filing of the complaint through to the settlement and recovery, should be monitored and Plan eligibility determined.
- Clear procedures should be established with the Custodian Bank as to the action that should be taken when a notice of a settlement is received. Plans should be aware of how long the Custodian Bank maintains records and consider extending this time period in its contract if necessary.
- To assist in determining eligibility for settlement, Plans should maintain documentation on the purchase and sale of the securities that the Plan currently holds and previously held, including the duration and amount owned as well as all transactions executed for each holding.
- Accurate record keeping is critical because settlement notices may not be circulated until many years after the time the Plan incurred the loss and it is not unusual to need access to investment transactions and holdings that are many years old in order to file a complete and valid claim. Processes should be established to ensure the complete and accurate transfer of Plan trade activity data in the event that the Custodian Bank or other third party maintains this data.
- Periodic reviews should be conducted to ensure that monitoring procedures are followed.

Participating in Recovery of Settled Claims

Loss recovery procedures must be established for a Plan to participate in the settlement as an eligible class member where a security is the subject of a recovery. The following issues should be considered when designing these procedures:

- Designate one individual or entity to file recovery forms (proof of claim). This is typically the Custodian or Counsel to the Plan but may also include internal staff. If different from the monitoring official, procedures should be in place to facilitate close coordination.
- Complete and file timely proof of claim forms including supporting documentary evidence with the settlement administrator.
- Monitor processing of filed claims through receipt of recovery.
- Periodically review the recoveries for larger claims to verify that the Plan's settlement allocation was calculated in accordance with the court-approved plan of allocation and to ensure the Plan received all monies it was entitled. This may be done internally or by a third-party.
- Even when a law firm files proof of claim forms, payments from the settlement administrator should be sent directly to the Custodian Bank to avoid delays in receipt of funds.

² Cox, James D. and Randall S. Thomas. *Letting Billions Slip Through Your Fingers*. Stanford Law Review. December 2005.

³ Plans should consider whether the involved entities are, or should be, a fiduciary of the Plan in accordance with state and local statute.

- All Plans should have a standing directive with the Custodian that designates where settlement funds should be deposited.

Reporting

Any entity or individual involved with securities litigation on behalf of the Plan, whether internal or external, should maintain a record of related activities for inclusion in a regular report to the CAO and Board including the status of all eligible claims and recoveries.

Selecting and Working with Legal Advisors

Plans that choose to utilize external legal counsel should first clarify the intended role of outside counsel. Solicitations for outside counsel should be coordinated through the Plan's general counsel (GC), CAO and Board and an RFP process should be utilized.

The GC and CAO should clarify the working relationship with outside legal counsel. This should include: agreeing upon the Plan's goals/objectives and expected outcomes as they relate to securities litigation; clarifying the roles and responsibilities of the outside counsel, GC, CAO and Board with a particular emphasis on decision-making responsibility; and the means and timing of communication and reporting.

Where counsel is elected or appointed independent of the Board, the Plan should consider entering into a Memorandum of Understanding (MOU) with counsel to clarify the fiduciary and other responsibilities of each party. This MOU may be an appendix to the policy.

Serving as Lead Plaintiff

While pursuing lead plaintiff status requires a separate evaluation not covered as part of this recommended practice, it is important that Plans establish a policy related to this decision. Most Plans make the decision to seek lead (or co-lead) plaintiff on a case-by-case basis. Some establish a loss threshold that must be met before the Plan considers seeking lead plaintiff status. Most Plans will never meet the lead plaintiff eligibility requirements under the PSLRA and as such, many Plans include in their policy an expressed prohibition on seeking lead plaintiff status.

References

- The National Association of Public Pension Attorneys (www.nappa.org).
- The Stanford Law School Securities Class Action Clearinghouse (<http://www.securities.stanford.edu/>).
- The National Association of State Retirement Administrators (www.nasra.org).
- The Securities Exchange Commission (www.sec.gov).

Approved by the GFOA's Executive Board, October 6, 2006.