



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 16

MEETING DATE: February 21, 2018

SUBJECT: Securities Litigation Update

SUBMITTED FOR: ___ Consent ___ Deliberation and Action X Receive and File

RECOMMENDATION

That the Board receives and files this securities litigation report.

PURPOSE

To provide an update to the Board regarding SCERS' 2017 securities litigation activities.

INTRODUCTION

Since Staff's last report to the Board on securities litigation, Staff has retained service providers to conduct an audit of its securities claim filing process. Staff confirmed that the claims of value that should have been filed, were in fact filed. Staff retained Financial Recovery Technologies (FRT) to review and re-file several securities claims under a new approach which resulted in an additional recovery of \$244,328. SCERS also retained FRT to conduct claims filing services, which resulted in identifying an increased recognized loss of \$86,760 for calendar year 2017. Staff has been able to accomplish this approach with an increase in expenses of \$5,000 to calendar year 2017.

BACKGROUND

The Board has a Securities Litigation Policy that establishes guidelines for monitoring, evaluating, and participating in securities litigation class action cases. Participation in these cases can fall along a spectrum of activities, ranging from filing a claim for damages incurred during a specified claim period to acting as a lead plaintiff in a class action lawsuit. In order for the Board to fulfill its fiduciary duty, non-participation is not an option. At a minimum the Board must establish a procedure for monitoring filed class action lawsuits, evaluating whether the fund has sustained a loss and ensuring that the required claim forms are filed on time, and that recovery is secured. The Board has satisfied that standard. Below is an overview of the SCERS' recent securities litigation activities.

For the past several years, in a coordinated effort with State Street Bank (SSB), law firm monitoring services (which are provided at no charge) have provided assistance to SCERS in identifying securities class action cases that involve companies whose securities are held in SCERS' portfolio.¹ Currently, three law firms provide monitoring services to SCERS. Together, the law firms and SSB have ensured that SCERS receives notice of potential financial recoveries to which it was entitled.

Over 10 years ago, SCERS retained Investor Recovery Support Service (IRSS). IRSS predated the monitoring services provided by security litigation law firms. When initially hired, SCERS used IRSS as a secondary source to SSB to monitor security litigation activities. IRSS charged SCERS an annual fee for its services. When security litigation law firms began providing monitoring services free of charge, SCERS continued its relationship with IRSS. Security litigation firms, while providing their monitoring services free of charge, often approach SCERS about actively participating in lawsuits as a litigant. IRSS simply provided monitoring services and permitted SCERS to confirm the case filings, claims periods, and damage assessments communicated by the law firms. Four years ago, IRSS was acquired by Financial Recovery Technologies (FRT) with the intent of expanding IRSS' services into audit and claims filing services. In 2016, FRT approached SCERS about conducting a claims filing audit.

DISCUSSION

Staff concluded that an audit of the process would help confirm that our service providers had identified and filed claims in all the cases that SCERS incurred a loss. Having a previous relationship with FRT, SCERS retained FRT to conduct the audit to review claims filed within the previous 12 months. At the conclusion of the audit in 2016, FRT concluded that in the preceding year SCERS was eligible to file claims in 25 cases. SCERS filed in 23. While two claims were not filed, review concluded that any potential recovery in those cases was nominal, if any.

Following the audit, FRT approached SCERS with a proposal. FRT noted that of the 25 claims audited, 8 were at the stage in the claims process where SSB had filed a claim, but the claims administrator had not yet distributed funds. FRT proposed to evaluate those 8 claims and determine whether additional recovery (recovery in excess of the amount filed for recovery by SSB) was possible. Having been satisfied with FRT's performance with the audit, SCERS was receptive to FRT's suggestion to continue the relationship.

FRT proposed that should it find additional recovery, it would charge a 25% fee and SCERS would recover the remaining 75% windfall. FRT explained that when a custodian bank receives notice of a securities claim, it examines which investment accounts hold the subject security and it files a separate claim on behalf each investment account. So, one institutional client could have several claims filed to recover for a single securities action. This approach is referred to as a "disaggregate" approach. Each claim is filed individually in a disaggregate method. FRT has concluded, based upon proprietary analysis that in certain securities cases filing for all claims under one filing, referred to as an "aggregate" approach, yields higher

¹ The following law firms provide monitoring services at no charge to SCERS: (1) Bernstein Litowitz Berger and Grossmann LLP (BLBG), (2) Grant & Eisenhofer (GE), and (3) Kessler Topaz, Meltzer and Check (KTMC).

returns. FRT explained that the aggregate approach does not yield improved results in all cases. It is their proprietary analysis that determines when to apply the aggregate approach and when to use the traditional disaggregate approach. Of the 8 claims still open, FRT proposed to re-file claims in 5 of them and one case that had recently disbursed funds. Over the next 10-12 months, FRT recovered an additional \$325,770, above and beyond what SSB would have recovered. SCERS received \$244,328 after fees.

Following the audit and the re-filing of claims activities, SCERS and FRT discussed transferring securities litigation claims filing activities from SSB to FRT. At that time in 2016, SCERS was paying FRT \$25,000 per year to monitor claims. FRT proposed to continue its claims monitoring service and add claims filing services for an annual fee of \$45,000. SCERS inquired from SSB how much it charges SCERS for securities claims services. SSB estimated that it charges about \$10,000 per year as part of the custodial agreement to file SCERS' securities litigation claims. SCERS internally questioned why it would want to incur more in expenses for services that it already received. FRT represented that it believed that it could increase SCERS' securities litigation recoveries by 15% and it would guarantee a 10% increase (\$35,000 to \$50,000) or refund \$15,000 of the annual service fee. Based upon these terms, SCERS agreed to transfer the claims filing services to FRT for a trial three-year period.

The table below demonstrates FRT's claims filing activities on behalf of SCERS for calendar year 2017. During calendar year 2017, FRT filed 24 claims. Of the 24 claims, FRT has identified 3 that will recover more under an aggregate approach. These cases are highlighted in yellow in the table below. The other 21 claims were filed under the disaggregate approach. The increase recognized loss from the 3 aggregate cases will result in an increase of \$86,760 (8%) for the claims filed in 2017. Of the recognized loss, SCERS can expect to recover approximately 5% for its pro rata share, or about \$4,350. Despite an increase in recognized loss, under the terms of the claims filing contract with FRT, SCERS will be receiving a \$15,000 fee reduction on its next invoice. It is anticipated, based upon the cases that FRT is tracking, but filed after 2017 that the 10% figure will be reached in following years.

CASES FILED IN 2017

Case Name	Disaggregate Recognized Loss	Aggregate Recognized Loss	% increase
TERRAFORM POWER, INC.	12,620.80	12,620.80	
BRIXMOR PROPERTY GROUP INC.	731.70	244.20	
OCWEN FINANCIAL CORPORATION	118,281.04	118,281.04	
FUQI INTERNATIONAL, INC.	11,343.43	11,343.43	
GENWORTH FINANCIAL, INC.	6,290.00	6,290.00	
AEGERION PHARMACEUTICALS, INC.	0.00	0.00	
CORINTHIAN COLLEGES, INC.	0.00	0.00	
TEXTURA CORPORATION.	103,063.13	103,063.13	
RAYONIER INC.	0.00	0.00	
MANULIFE ONTARIO	0.00	0.00	
ITC HOLDINGS CORPORATION.	0.00	0.00	
ACADIA PHARMACEUTICALS INC.	0.00	0.00	
COMPUTER SCIENCES CORPORATION	344,993.54	429,157.44	24%
HARMAN INTERNATIONAL INDUSTRIES, INC.	0.00	0.00	
DFC GLOBAL CORPORATION	269,872.84	269,872.84	
HORTONWORKS, INC.	181,708.04	181,708.04	
SALIX PHARMACEUTICALS, LTD.	1,603.24	1,603.24	
L-3 COMMUNICATIONS HOLDINGS, INC.	0.00	0.00	
RUBY TUESDAY, INC.	0.00	0.00	
ALTISOURCE PORTFOLIO SOLUTIONS S.A.	0.00	0.00	
MOLYCORP, INC.	23,345.00	25,578.00	10%
SINO-FOREST CORPORATION	0.00	0.00	
PTC INC.	3,570.00	0.00	
CVB FINANCIAL CORPORATION	7,600.20	7,962.90	5%

CONCLUSION

After one year of our partnership with FRT, Staff believes that SCERS is on the right track transitioning from SSB to FRT for claims filing services. Staff will continue to monitor and report back to the Board.

ATTACHMENTS

None

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