



MINUTES

**Special Meeting of the Board of Trustees
of the State Universities Retirement System
Board Retreat**

Wednesday, October 23, 2024, at 9:00 a.m.

State Universities Retirement System

1901 Fox Dr. – Main Conference Room – Champaign, IL 61820

Optional Remote Connection for Members of the Public

This meeting was conducted in person at the State Universities Retirement System in Champaign, IL

The following trustees were present: Dr. Andriy Bodnaruk; Mr. Richard Figueroa; Dr. Fred Giertz, Mr. Scott Hendrie, Mr. Pranav Kothari, Mr. John Lyons, Mr. Herbert Pitman, Dr. Steven Rock, Mr. Collin Van Meter and Mr. Antonio Vasquez.

Others present: Ms. Suzanne Mayer, Executive Director; Ms. Bianca Green, General Counsel; Mr. Albert Lee, Associate General Counsel; Ms. Heather Kimmons, Associate Legal Counsel; Mr. Michael Schlachter, Chief Investment Officer; Ms. Anna Dempsey, Investment Counsel; Ms. Nichole Hemming, Chief Human Resources Officer; Mr. Jefferey Saiger, Chief Technology Officer; Ms. Tara Myers, Chief Financial Officer; Ms. Jackie Hohn, Chief Internal Auditor; Ms. Kristen Houch, Director of Legislative and Stakeholder Relations; Ms. Kelly Carson, Ms. Chelsea McCarty and Ms. Annette Ackerman, Executive Assistants; and Mr. Michael Calabrese of Foley.

Board of trustees roll call attendance was taken. Trustee Bodnaruk, not called; Trustee Figueroa, not called; Trustee Giertz, present; Trustee Hendrie, present; Trustee Kothari, present; Trustee Lyons, present; Trustee Pitman, present; Trustee Rock, not called; Trustee Van Meter, present; and Trustee Vasquez, absent.

Trustee Vasquez joined the meeting in person at 9:15 a.m.

TRUSTEE APPROVAL TO PARTICIPATE VIA ELECTRONIC MEANS

Trustee Hendrie made the following motion:

- That Trustees Bodnaruk, Figueroa and Rock be allowed to participate via video or conference call for the board retreat on October 23, 2024, pursuant to Section 7(a) of the Open Meetings Act.

Trustee Kothari seconded the motion which passed via the following roll call vote.

Trustee Bodnaruk - not called
Trustee Figueroa - not called
Trustee Giertz - aye
Trustee Hendrie - aye
Trustee Kothari - aye
Trustee Lyons - aye
Trustee Pitman - aye
Trustee Rock - not called
Trustee Van Meter - aye
Trustee Vasquez - aye

Roll call attendance for trustees participating via electronic means was taken: Trustee Bodnaruk, present; Trustee Figueroa, present and Trustee Rock, present.

**FIDUCIARY TRAINING, ESG AND RECENT LEGAL DEVELOPMENTS, AND
OVERVIEW OF INVESTMENT MANAGER PROCESS (EDUCATIONAL SESSION)**

Mr. Michael Calabrese, Ms. M.C. Cravatta and Mr. Michael Schlacter each provided portions of the Fiduciary training to the Board of Trustees which covered multiple topics including, but not limited to; fiduciary duty, ethics, Illinois gift ban act, ESG, and investment selections.

The educational session began at 9:05 a.m. and concluded at 1:15 p.m.

The presentation provided by Foley titled “SURS Board Presentation on Fiduciary Duty and Related Topics Oct 2024” has been incorporated into these minutes as [Exhibit 1](#).

**REVIEW AND POTENTIAL APPROVAL OF UPDATES TO THE BOARD POLICIES,
BOARD BYLAWS AND BOARD COMMITTEE CHARTERS**

Ms. Bianca Green conducted an extensive review of the Board Bylaws and accepted redline changes to the same as directed by the board members. Those changes will be presented during the December 2024 Board meeting. Due to time limitations, the SURS Board of Trustees agreed to defer its discussion of the Board Policies and the Board Committee Charter to a later date and time. No motions were made during this meeting and discussion regarding these remaining topics will be revisited during a future board meeting.

**FREEDOM OF INFORMATION ACT (FOIA) AND ILLINOIS OPEN MEETINGS ACT
(OMA) (EDUCATIONAL SESSION)**

Due to time limitations, the SURS Board of Trustees agreed that the FOIA training and OMA educational sessions will be deferred to a different date and time.

PUBLIC COMMENT

There were no public comments presented to the SURS Board of Trustees.

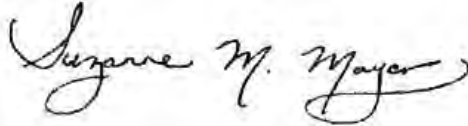
TRUSTEE COMMENT

There were no trustee comments.

ADJOURN

There was no further business brought before the board and Trustee Hendrie moved to adjourn the meeting. The motion was seconded by Trustee Kothari, and it passed via all trustees present voting in favor of adjourning the meeting.

Respectfully submitted,

A handwritten signature in black ink, reading "Suzanne M. Mayer". The signature is written in a cursive style with a large initial 'S' and a long, sweeping underline.

Ms. Suzanne M. Mayer
Executive Director and Secretary, Board of Trustees

SMM:cm



WHAT YOU MUST DO, AND WHY

TRUSTEE FIDUCIARY DUTIES

Presented by:

Michael Calabrese & M.C. Cravatta
Foley & Lardner LLP

FOLEY.COM

Agenda

- Fiduciary Duties
 - Duties of Care, Loyalty, and Obedience
 - Fundamental Responsibilities of Trustees
- Ethics
- Fiduciary duties in Action
 - *Students for Fair Admissions* Implications for SURS
 - Vetting Investments
 - ESG Investing



Fiduciary Duties

Fundamental Responsibilities of a Trustee

1. Act in the best interests of members	6. Deal fairly with members
2. Use prudent judgment	7. Act consistent with your mission
3. Act diligently and competently	8. Monitor staff and providers
4. Maintain your independence and objectivity	9. Maintain confidentiality, when appropriate
5. Comply with the law	10. Strive for transparency

Fiduciary Duty (40 Ill. Comp. Stat. Ann. 5/1-109):

Duties of Fiduciaries. A fiduciary with respect to a retirement system or pension fund established under this Code shall discharge his or her duties with respect to the retirement system or pension fund ***solely in the interest of the participants and beneficiaries*** and:

- a) For the ***exclusive purpose*** of:
 - 1) ***Providing benefits*** to participants and their beneficiaries; and
 - 2) Defraying reasonable expenses of administering the retirement system or pension fund;
- b) With the ***care, skill, prudence and diligence*** under the circumstances then prevailing that a prudent person acting in a like capacity and ***familiar with such matters*** would use in the conduct of an enterprise of a like character with like aims;
- c) By diversifying the investments of the retirement system or pension fund so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
- d) In accordance with the provisions of the Article of [the Pension] Code governing the retirement system or pension fund

The Duties of Due Care, Loyalty and Obedience Control Everything You Do

All 10 responsibilities are derived from just three fundamental principles to which all Trustees must adhere:

- **The Duty of Due Care**
 - Generally, you must act with the care, skill, diligence and **prudence** exercised by similar fiduciaries who know what they're doing.
 - *You should exercise a HEIGHTENED degree of prudence in managing the System's affairs—more than just ordinary prudence.*
- **The Duty of Loyalty**
 - Simply put, you owe your fealty to the financial interests of the System's members and beneficiaries, and no one and nothing else.
- **The Duty of Obedience**
 - You must comply with law and policy.



THE DUTIES OF DUE CARE, LOYALTY AND OBEDIENCE ARE ALL MEASURED ACCORDING TO THE FACTS KNOWN TO YOU AT THE TIME YOU MADE A DECISION, NOT BY HINDSIGHT

Acting in the Best Interest of the Members: What Does That *Really* Mean?

- It means you must generally resolve conflicts in favor of the members and their beneficiaries.
 - Thus, in conflicts between Members and their Employers: the interests of members must prevail. (But let's talk about *Bandt v. SDCERA*.)
 - In conflicts between Active Members and Retired Members: you must use your best efforts to deal fairly with each class, but ultimately, do what's in the best interests of the System as a whole.
 - In conflicts between the System and those appointing the System's Trustees: you must do what serves the members' interests, even if it means you anger the appointing power.
 - Conflicts between Staff and the System: whose interests must prevail?
 - How does this work when it comes to decisions about benefits for particular Members?

THE CONTROLLING PRINCIPLE: ALL ACTIONS MUST BE FOR THE EXCLUSIVE BENEFIT OF THE MEMBERS AND THEIR BENEFICIARIES, WHATEVER THE CONSEQUENCES

Exercising Prudent Judgment: What Does That *Really* Mean?

- **Is it prudent to undertake tasks you're not qualified to assess or handle?** Delegation is critical when expertise is lacking.
- **Is it prudent to eschew critical advice before risks become manifest?** Early reliance upon professional advice can avert disaster.
- **Is it prudent to ignore industry trends?** A healthy fund stays abreast of the latest trends and developments, knowing nothing remains static.
- **Is it prudent to presume things are well because no one has complained otherwise?** What you don't know may hurt you. Inquire.



Acting Diligently and Competently: What Does That *Really* Mean?

- **KNOWLEDGE:** You must become knowledgeable about the System you govern, learning as much as you can about the System's terms and policies, as well as its staff, vendors and consultants, and importantly, its various constituencies.
- **ENGAGE:** You must become sufficiently conversant with the issues facing the System that you can constructively participate in efforts to improve it.
- **CONTINUED EDUCATION:** You must never presume you know everything there is to know in your role as trustee—you should regularly engage in educational opportunities to hone your expertise.
- **GUIDANCE:** When faced with issues outside your experience, seek appropriate assistance, whether internal or external.



Acting Consistently with Your Mission: Why Is That Important?

- Inconsistent action invites claims of favoritism;
Consistent action shows fairness
- Inconsistent action suggests doubt; Consistent
action suggests competence
- Inconsistent action invites challenge;
Consistent action breeds confidence
- Inconsistent action obscures the mission;
Consistent action reinforces the mission

Trust is built
with
consistency.
Lincoln Chafee

meetville.com

Monitoring the Effectiveness of Staff and Service Providers, as well as System Programs

- The wisdom of this is self-evident, but too many trustees fail to take an active role in evaluating staff, service providers and programs
- **The best way to ensure the System's optimum operation is to constantly evaluate the effectiveness of those who operate it and the programs they implement**
 - Thus, in *Tibble v. Edison*, the US Supreme Court held that separate and apart from a trustee's duty to exercise prudence in selecting investments, the trustee has a continuing duty to evaluate the continued reasonableness of those investments — perhaps it is no longer suitable for the plan's objectives, or has proven unprofitable, or overly expensive, and should be redeemed or replaced.
 - Reinforcing and applying *Tibble*, in *Hughes v. Northwestern University*, SCOTUS held that the fact that members of a DC plan could choose their own investments did not excuse trustees' failure to remove inappropriate options.

The Tension Between Confidentiality and Transparency

- As public officers, we are duty bound to do much of our work in the public eye—but there are important exceptions, which must be honored:
 - Much of our investment analysis must be kept secret
 - Legal advice is protected from disclosure
 - Executive Session Meetings must be kept confidential
 - Confidential member information must be preserved





Ethics

Why Care About Ethics?

We already know that as trustees, you have a duty of due care, loyalty and of obedience—and **arising from your duty of loyalty, as well as obedience, is the obligation to act ethically.**

- Your ethical conduct will **engender like conduct in the System's staff**, consultants and advisors, and deter wrongful behavior
- Your ethical conduct will **increase staff morale, heighten confidence by the members, employers and other stakeholders that the System is being responsibly managed, and provide a coherent framework for navigating difficult issues**
- Your ethical conduct will **assure the System complies with all requirements**



What Ethical Qualities Do We Want to Promote?

By exhibiting sterling character and competent performance, trustees encourage those working for them to exhibit many salutary qualities, such as:

- Honesty, integrity, courage, fairness, respect, compassion, goodwill, loyalty, professionalism, diligence, prudence, excellence, teamwork, reliability and humility
- Exhibiting these good qualities reduces the likelihood of serious harm to the organization in the form of:
 - Legal exposure
 - Reputational damage
 - Low morale
 - Poor performance and
 - Unlawful behavior

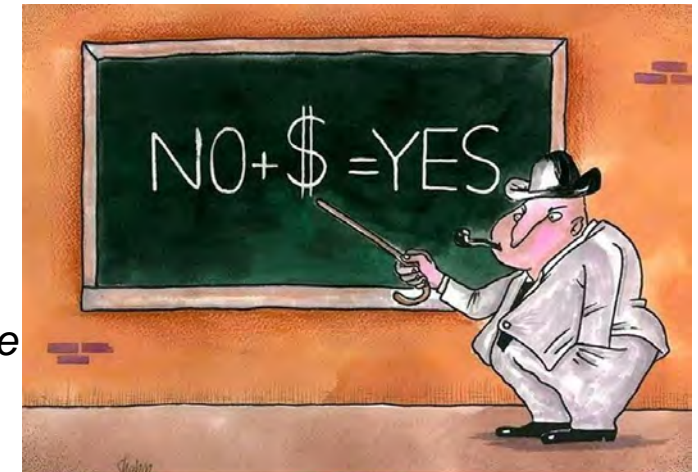


Gifts

- **Both the law and our SURS policy says you should refrain from accepting gifts which are explicitly or implicitly designed to improperly influence your decisions as trustees**
- While this doesn't mean you are precluded from having a meal purchased for you on occasion by someone who is doing business with the system...
- You must refrain from accepting gifts which are intended to influence the decisions you would otherwise make **but for** the gift

Example: You are considering a particular investment for the System—the IR manager offers you a “free” two-week cruise to Tahiti if you make the investment. Is this a prohibited gift? (Query: *Is the cruise intended to influence the decision you would otherwise make but for the cruise?*)

Would your answer be the same if the manager did not condition the cruise on your making the investment but instead, just attending a half day seminar on the cruise about the investment? What if the manager is also your college roommate and best friend, and you've been exchanging this sort of gift for decades?



Illinois Ethics Act – Gift Ban

(5 ILCS 430/10-10) Gift Ban. Except as otherwise provided in this Article, no officer, member, or State employee shall intentionally solicit or accept any gift from any **prohibited source** or in violation of any federal or State statute, rule, or regulation. This ban applies to and includes the **spouse of and immediate family living with** the officer, member, or State employee. No prohibited source shall intentionally offer or make a gift that violates this Section.

A “gift” is defined as: “...any gratuity, discount, entertainment, hospitality, loan, forbearance, or other tangible or intangible **item having monetary value** including, but not limited to, cash, food and drink, and **honoraria** for speaking engagements related to or **attributable to** government employment or **the official position** of an employee, member, or officer.”

A prohibited source is any person who: (1) is seeking official action; (2) does business with or seeks to do business with SURS; (3) conducts activities regulated by SURS; (4) has interests that may be substantially affected by the performance or non-performance of the official’s duties; or (5) is a registered lobbyist.

Illinois Ethics Act – Gift Ban Exceptions

- Exceptions to the Gift Ban include (not a complete list):
 - lawful campaign contributions
 - travel expenses for a meeting to discuss State Business
 - gifts from relatives
 - gifts on the basis of personal friendship (unless...)
 - food or refreshments not exceeding \$75 per person in value on a single calendar day
 - benefits resulting from the outside business or employment activities, bequests, inheritances, and other transfers at death
 - items from any one prohibited source during any calendar year having a cumulative total value of less than \$100

Conflicting Outside Interests

While trustees cannot take official action, in their capacity as trustees, in contravention of their duties to the System's members, does their loyalty to the members extend **beyond** their official actions as trustees?

Examples:

- Can a trustee borrow from the System's custodial bank or investment manager?
- Can a trustee hire a vendor, adviser or consultant already retained by the System?
- Can a trustee buy property from a joint venture in which the System owns an interest?

Answer: In the event a trustee has a financial interest in activities outside of the System which may conflict with the System's interests or appear to affect the trustee's loyalty to the System, he may not contract with System investment managers or advisors UNLESS those persons are normally engaged in such contracts for the public generally and the terms of their contracts with the trustee are market.

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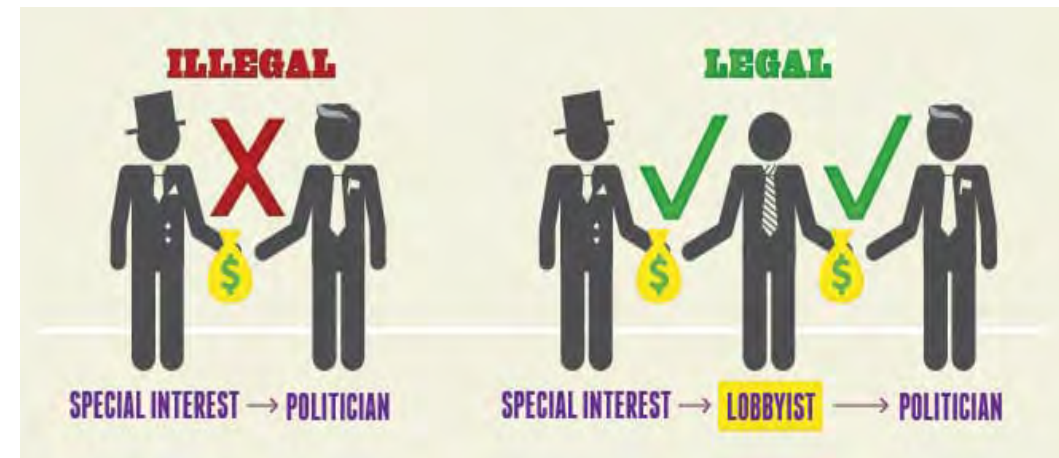
"Try this—I just bought a hundred shares."

Hiring Practices

Not surprisingly, trustees (like staff) must refrain from receiving anything of value in exchange for retaining consultants, advisors, investment managers, staff or vendors for the System

- Thus, a trustee cannot arrange for an investment manager to be retained by the System in exchange for the manager hiring the trustee, his relatives or any of their businesses, or paying any of them a kickback.
- Nor can a trustee do any of those things through a middle-man or agent

Thus, it was clearly not OK for CalPERS to pay \$14 million to its former board chair, who acted as a middleman for investment funds retained by CalPERS, in exchange for the former board chair's kickback of thousands of dollars in gifts to CalPERS' CEO.



Attendance at Functions

You should refrain from attending meetings **paid for by others** which might jeopardize your independence and objectivity—such as those promoting a specific business or product, and especially, a business or product not suited for use by the System.

Example: Jane Trustee is invited by an investment firm currently under criminal indictment for violations of the Foreign Corrupt Practices Act to attend a three day, all expense paid trip to NYC—

Knowing there is little chance Staff will consider investing in the firm and its products, Jane attends anyway since she always wanted to go to NYC and can't afford to spend three days there on her own dime. When asked about the trip, Jane justifies it on grounds she wanted to know more about the firm and its products, despite the indictment, which she says, might be just an isolated incident not really reflective of the firm's ethics.

Was Jane's trip to NYC ethical? Wise?

In contrast, attendance at conferences involving topics pertinent to management of the System and not intended to promote a particular business are perfectly acceptable.

Example: Same example as above but Jane is invited to attend a conference on trends in emerging market investments sponsored by 10 investment managers and ILPA, the Institutional Limited Partners' Association. Jane attends because she wants to learn more about these types of investments.

Any question about the ethics of Jane's attendance at this conference?



Fiduciary Duties in Action:

Students for Fair Admissions, Inc.
Implications for SURS

Status of Educational Affirmative Action Pre-2024

- 1978 — *Regents of the University of California v. Bakke*
 - SCOTUS held “quota systems” are an unconstitutional violation of the Equal Protection Clause of the 14th Amendment.
 - Requires the government to show a “**compelling interest**” for any race-based (or other similarly based) classification and to demonstrate that the at-issue policy is “**narrowly tailored**” to achieve this compelling interest.
 - College admissions COULD still consider race as one factor among many others in their admissions decisions.
- 2003 — *Grutter v. Bollinger*
 - SCOTUS found student body diversity could be a compelling interest to justify the consideration of race in admissions.
 - **BUT:** (1) can’t let use of race become “negative stereotyping;” (2) can’t use race as a “negative” to other racial groups; (3) “the use of racial preferences will no longer be necessary to further the interest approved today” in 25 years.

Students for Fair Admissions, Inc. v. Harvard College ***Students for Fair Admissions, Inc. v. University of North Carolina***

- Found the policies violated the Equal Protection Clause of the Fourteenth Amendment.
 - The purported “**compelling interests**” behind the admissions programs (training future leaders, acquiring knowledge based on diverse outlooks, promoting a robust marketplace of ideas, creating engaged and productive citizens) could not be evaluated because the Court found them “**immeasurable.**”
 - The Court found that that the admissions **programs did not have a meaningful connection** between their goals and the means employed to achieve those goals. The programs used racial categories that were overly broad, arbitrary or undefined, or underinclusive.
- Did not expressly overturn *Grutter* but tried to clarify by finding:
 - The policies relied on “stereotyping.”
 - The policies had a “negative effect” on Asian Americans.
 - The policies had no “logical end point.”



So, Are DEI Efforts Still Legal, or What?

- **DEI efforts are still legal in general.** *SFFA* did not make DEI efforts illegal; rather, while there were some limited instances where a “plus factor” could be applied *in the realm of education*, that is no longer permitted.
- So long as DEI efforts are created in a manner that does not take race, gender, etc. into account *to drive an actual decision* (employment, manager selection, etc.), then it appears, at least for now, DEI will continue to be legal.
- But *SFFA* should be a wake-up call to ensure that DEI programs are appropriately drafted and implemented.



Plaintiffs Are Using *SFFA* in Many Contexts

- Challenging diversity targets and associated compensation and promotion decisions.
- Challenging economic bonuses provided ONLY to certain underrepresented groups.
- Challenging fellowships and scholarships that are restricted to certain underrepresented groups.
- Challenging resources, opportunities, or trainings provided to certain underrepresented groups through affinity groups or the like.
- Challenging grant programs target to minority-owned businesses.
- Challenging favorable banking terms for customers of minority-owned banks.
- Challenging a venture capital fund's program to direct investment to women-of-color-led businesses.
- Challenging the termination of an employee for refusal to take DEI training.



Powers v. Broken Hill Proprietary Inv.

District Court for Southern District of Texas

- Plaintiff claimed sex discrimination under Title VII and post-termination retaliation.
- Plaintiff alleged that company announced initiative to increase the female workforce to 50% by 2025.
- Plaintiff alleged that the company considered progress towards the goal of gender balance as a metric in determining the overall annual bonus pool and in determining individual bonuses for employees.
- On summary judgment, Court held that there was a factual dispute as to whether the “BHP’s gender-balance goal, including its tie to the performance evaluation and bonuses of those making the hiring and promotion decisions at issue, amounts to an unlawful affirmative action plan that adversely affected Power’s employment.”
- The case settled shortly after the summary judgment decision.



Am. Alliance for Equal Rights v. Morrison Foerster LLP

District Court for Southern District of Florida

Am. Alliance for Equal Rights v. Perkins Coie LLP

District Court for Northern District of Texas

- Plaintiffs in both cases allege that the firms' fellowship programs, which are limited to underrepresented minorities, LGBTQ, and disabled applicants, violate 42 U.S.C. § 1981.
- These fellowships are awarded to applicants who then participate in the firms' summer associate programs.
- Plaintiffs sought declaratory judgments that the fellowships violate 42 U.S.C. § 1981, as well as injunctions.
- Both firms quickly amended their programs—now seeking candidates committed to diversity versus candidates who are themselves diverse.



Bolduc v. Amazon.com Inc. **District Court for the Eastern District of Texas**



- Class action complaint under 42 U.S.C. § 1981 alleging company engaged in unlawful racial discrimination by providing a \$10,000 bonus to Black, Latinx, and Native American entrepreneurs who acted as its delivery service partners, while withholding this stipend from Asian-American and Caucasian people who deliver packages.
- Motion to dismiss currently pending.

Roberts v. Progressive Insurance

Northern District of Ohio

- Progressive Insurance had a program under which only Black-owned commercial trucking businesses would be eligible for certain grants.
- Plaintiff brought claims under Section 1981.
- Defendant moved to dismiss, claiming:
 - The program was valid affirmative action
 - The program was also protected under the First Amendment (similar to *Fearless Fund*)
 - Causation had not been shown.
- District Court dismissed the case on the basis of standing. While it nominally declined to reach the merits, a key factor was that the plaintiff failed to allege that it would have received a grant if the program had been race-neutral.
- Currently on appeal to the Sixth Circuit.





Fiduciary Duties in Action:

Vetting Investments

Duty of Care: Vetting Investments

- The Duty of Care requires the **“Care, skill, prudence and diligence of a prudent person acting in a like capacity and familiar with such matters.”**
 - You must make wise investment decisions, monitor the results, and change course if prudence requires it.
- This involves both procedural and substantive reasonableness.
 - You may, and sometimes must, consult with experts and/or delegate, but with:
 - Care in selection and monitoring, and
 - Reasonable scrutiny by Trustees of expert recommendations.

SURS' Process for Selecting Investments

- ❑ Step 1 – Staff and/or the Investment Committee determines that a search should be done. Staff can start a search without specific approval, or the IC might determine that a manager should be added.
- ❑ Step 2 – Staff writes an RFP and posts it to the website.
- ❑ Step 3 – Staff and the general consultant (Meketa) review all responses, and determine semifinalists.
- ❑ Step 4 – Staff and the consultant interview semifinalists in Champaign (Board members join, sometimes, if available and interested).
- ❑ Step 5 – Staff and the consultant interview short-list finalists in their offices.
- ❑ Step 6 – Staff and the consultant determine the tentative “winner(s).”
- ❑ Step 7 – The chosen investment manager(s) presents to the Investment Committee for ratification.

Communications with Potential Investment Managers and Selection of Potential Investment Managers and Strategies

- While Trustees are not generally *prohibited* from communicating with potential investment managers, there are certain principles that Trustees should follow as to **how** to conduct these interactions so as not to taint the prudent selection of investment managers:
 - Trustees must not work outside the normal process and take on the role of *affirmatively advocating for specific investments or relationships*, as opposed to their prescribed role of vetting and deciding upon recommendations at the end of a formal process.
 - Trustees must remember that written communications between SURS Trustees and outside parties will generally be public documents, available to anyone to request under Illinois' Freedom of Information Act and could be used as Court evidence should their actions come into question.

Communications with Potential Investment Managers and Selection of Potential Investment Managers and Strategies (Cont.)

- Trustees must not violate policies or law.
 - *E.g.*, Trustees should not accept gifts from managers.
 - *E.g.*, Trustees should not discuss pending procurements during the applicable quiet period.
- Trustees should avoid affirmatively recommending a meeting, which could be construed as an endorsement of the manager. Instead, Trustees should leave it entirely up to staff to decide whether to accept or pursue a meeting.
- Trustees should avoid statements that could later be construed as endorsements of managers.
- Trustees should avoid attending preliminary meetings with staff and managers, if such attendance would be unusual.

Failure to Adhere to the Principles for Trustee Communications with and Selection of Investment Managers and Strategies Introduces Risk

- Failure to adhere to these principles:
 - Cuts out valuable consultant and staff expertise;
 - Can introduce inappropriate factors like personal relationships, ancillary benefits, and politics into the selection process;
 - Encourages outside interests to try to skip the formal process, by going straight to the people with the final decision;
 - Even when it doesn't involve outright corruption, it will often mean choosing managers and other contractors that would not have made it through the more rigorous formal process.

“I ran into Bob the other day. I’ve known Bob for years. He runs Bob’s Investments. Turns out they’re raising a new fund, Bob’s Capital Partners III. You should meet with him. He’d do a great job for SURS.”

- Is there anything wrong with this? If so, what?
 - Duty of Loyalty
 - Duty of Prudence
 - Duty of Obedience

So What *Can* SURS Trustees Do?

- Trustees need not avoid interactions with investment managers. They are common and accepted in the industry and can contribute to positive relationships that benefit SURS and its members.
- Trustees can introduce managers to SURS' staff and consultants, when done appropriately.
 - “You should talk to our CIO, let me give you his contact information” should probably be a go-to statement for Trustees in such situations.
- Trustees can explain SURS' process to a manager representative or refer questions to staff
 - *E.g.*, “We hire in that asset class through a discretionary manager called Meketa. You should monitor their website for opportunities.”

Case Study:

Ohio State Teachers Retirement System

- The AG also investigated and recently found that a private investment entity (QED) and the Ohio Retired Teachers Association had targeted STRS for 4 years, which essentially resulted in a hostile takeover of STRS by private interests.
- Factors that led to this finding include, but are not limited to:
 - A Trustee “directed” STRS investment staff to connect with investment management firm QED, which proposed to manage 70% of the portfolio.
 - A board member raised concerns about STRS performance that mirrored QED’s claims.
 - Multiple board members submitted memos and requests on STRS letterhead that were actually drafted by QED.
 - Multiple board members pitched QED to STRS in a presentation.
 - Board continued to pursue retaining QED despite staff and independent consultants finding them unsuitable.

When Trustees Fail to Uphold Their Fiduciary Duties:

State of Ohio, ex rel. v. Wade Steen & Dr. Rudy Fichtenbaum

- Following an investigation, the Ohio Attorney General sued to remove certain individual board members from STRS for breach of fiduciary duties.
- The investigation summary found:
 - *“In summary, the extent to which certain current and former board members have for several years actively supported QED, a company that roundly failed due diligence by the board's investment consultant, seems in clear violation of their fiduciary duties. Moreover, the tactics they have employed—misrepresentations about the system, its investments and performance; personal attacks on staff and other board members; apparent failure to disclose campaign activities and expenses—raise questions of legality that potentially jeopardize the legitimacy, independence and authority of the entire board. At a minimum, this is not how fiduciaries to a public pension system operate. The sustained coordination among QED, ORTA leadership, and certain STRS board members suggests there is far more going on outside the purview of the board and those entities responsible for system oversight. Viewing their actions and interactions in total, the parties look, act, and operate like business partners acting in concert to achieve the same objective.”*



Fiduciary Duties in Action:

ESG Investing

Duty of Loyalty in “ESG” Investing

Depends what we mean by “ESG.”
There are two types of ESG investing:

COLLATERAL BENEFIT

Serves a societal or other benefit **independent** of the purpose of funding and providing benefits.

- Origins in classic Socially Responsible Investing (SRI)
- Unproblematic for some investors (e.g. Individuals).
- Raises issues for certain fiduciaries, including pension plan trustees.

RISK-RETURN

Focuses on ESG factors as **potential predictors of performance**.

- Permissible for pension plan trustees, if done consistently with fiduciary duty.
- If permissible, must be integrated into the selection process as a means of predicting net risk-adjusted performance, alongside traditional predictors like fees, track record, qualifications, etc.

ESG Investing and Public Pension Funds

Different perspectives:

a. Opposition/Caution

- NASRA's publication on ESG says that while it "does not have a position specifically on ESG," the organization supports the "paramount goal (of) financial security of pension fund assets (and) opposes any attempt to direct or influence state and local retirement system investments that circumvent the trustees' fiduciary responsibility."

ESG Investing and Public Pension Funds

Different perspectives:

b. Support

- CalSTRS: ESG factors may be considered “to the extent that such factors bear on the financial advisability of an investment, are a material risk to the fund, or weaken the trust of a significant portion of the members of the system.” However, fiduciary standards do not allow selection or rejection of an investment based on ESG alone.

Where does the authority to do ESG come from?

- a. Foley experience with clients affirmatively authorizing or requiring ESG:
 - NYC (Prisons, Guns, Public Jobs, NY Look-at).
 - Texas TRS (Restricted Securities List).
 - AZ (AZ Look-at, Israel Boycott).

- b. IL law: Any ESG efforts must fit within existing duties.
 - Manager Diversity Program: Gives diverse managers an advantage in getting interviews, but not necessarily investment contracts, and sets “aspirational” goals to be pursued, but only “within the bounds of financial and fiduciary prudence.” 40 ILCS 5/1-109.1

 - Sustainable Investing Act:
 - A public agency “shall prudently integrate sustainability factors into its investment decision-making...in order to maximize anticipated financial returns, minimize projected risk, and more effectively execute its fiduciary duty.” 30 ILCS 238/20.
 - Sustainability factors include: 1) Corporate Governance; 2) Environmental; 3) Social Capital; 4) Human Capital; 5) Business Model and Innovation.
 - This must be done ““within the bounds of financial and fiduciary prudence.” 40 ILCS 5/1-113.6 & 113.17.

Questions to Ask When Considering an ESG Proposal

- a. Can it be implemented on a basis that focuses on the plan's core duty to provide benefits, and avoids making decisions on a non-financial basis?
- b. Can this be measured on a short-term and long-term basis? What are the right benchmarks?
- c. Even if we think ESG factors are accretive, do we have good reason to think that separately considering ESG factors will help us make better investment decisions? If we think certain ESG factors correlate to performance, aren't those factors *already* implicitly influencing our performance-driven decisions?
- d. Can it be implemented in specific assets classes where it will have the most positive impact?
- e. Are the plan's investment staff and consultants comfortable with the answers to all of the above questions?
- f. *Ultimately, is there a compelling story to be told, backed by data, that explains how the Board, acting under the prudent expert standard, has made a decision that will, over time, maximize its ability to provide benefits to members?*

QUESTIONS?



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