

# CONFLICTS OF INTEREST AND UNDUE INFLUENCE

Board of Administration  
San Jose Federated City  
Employees' Retirement  
System

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# FIVE FUNDAMENTAL FIDUCIARY DUTIES

- Primary Loyalty Rule
- Exclusive Benefit Rule
- Duty of Prudence
- Duty to Diversify
- Follow the Plan



# FOCUS ON TWO DUTIES TODAY

1. **Primary Loyalty Rule** – Duty to act in the best interests of the members and beneficiaries, not to promote personal or others' interests (this duty takes precedence over all others).
2. **Duty of Prudence** – You must exercise the care and skill of a knowledgeable, prudent person charged with similar duties, under the prevailing circumstances.

# WHAT DOES IT MEAN TO BE LOYAL?

- An “interested” board, not a “representative” one
- A constituency of one – members/beneficiaries
- Avoid conflicts of interest – strongest loyalty test
  - Serving others’ interests
  - Personal financial interests
  - Accepting gifts that could influence you
- Observe the City Ethics Code
- When in doubt, disclose

# WHAT DOES IT MEAN TO BE PRUDENT?

- Deliberative, open and fair process matters more than results
- Staying within governance boundaries – let others do their jobs
- Avoiding biases, pressures that impinge on good judgment, impartiality
- Foster a culture of meritocracy

# SCENARIO #1

The Chair of the Investment Committee of the Big City Employees Retirement Assn. (BCERA) is invited as a guest to a charitable fundraiser for disadvantaged high school youth that raises funds for financial literacy education.

The gala is sponsored by two dozen prominent institutional investment management firms who have been promised the opportunity to socialize with trustees and investment executives from several western states' pension funds. The general admission to the event is \$500 per person, which includes a meal, beverages and a raffle ticket for the big door prize. The admission has been waived for guests like the Chair.

The Chair is flattered to be invited, and readily accepts. At the event, he is thrilled to meet with two firms that Investment Staff is interviewing that very week for new BCERA fixed income mandates. The Chair graciously offers to put in a good word for them.

*Any issues here?*

## SCENARIO #2

BCERA announces that it intends to downsize its pool of private equity managers, culling out the ones that underperform.

The Mayor hears of the plan, and calls the public trustee who sits as Chair of the Investment Committee. The Mayor says, "Do what you want, but Wing & Prayer LLC is my biggest re-election contributor; if you terminate them, your time on the board will be painfully short! They need to get *something* from us for all their contributions!"

Dutifully, the Chair approaches an investment officer and says, "Please don't mess with Wing & Prayer! Downtown wants them protected. But only you can fix this, I can't go to the CIO, he's a stubborn cuss and would do the exact opposite if I told him! You take care of this quietly and you could be in line to succeed the CIO!"

*Any issues here?*

## SCENARIO #3

A BCERA trustee who is a registered investment advisor is searching for new employment in the public equity space. During one manager interview, the interviewer hints that an introduction to BCERA might help the trustee land the job.

The next day, the trustee approaches BCERA's CIO and tells him that she believes this particular manager is "top quartile" and urges the CIO to bring them in for contract talks immediately. "You can skip the usual vetting process, you have my word on how good they are!" (The trustee does not disclose to the CIO her prospect for employment.)

Meanwhile, the CIO's team had already rejected that particular public equity manager because they had 100% turnover of their senior executives last year.

*What should the CIO do?*



# HOW SHOULD WE DEFINE “UNDUE INFLUENCE”?

The difference between “reasonable involvement” and “undue influence” can be tricky!

Things to avoid:

- Attempts to exert influence over decisions that deprive the responsible person(s) the ability to exercise prudent, unbiased judgment, including the ability to make a objective decision or recommendation
- Attempts by superiors to advocate for or direct staff to perform a delegated action or decision in a particular way
- Actions that are motivated by your own personal interests, or the interests of others

**When you delegate authority and responsibility, your delegates must act as fiduciaries, too. Let them!**