Minnesota Mirage: Sleight of Hand

Preliminary Findings of Forensic Investigation of Minnesota Teacher Retirement Association Crowdfunded by Minnesota Educators for Pension Reform Facebook Group

Benchmark Financial Services, Inc. September 25, 2024

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I. Executive Summary

- **Lack of Transparency**

Transparency in government has long been acknowledged in America as essential to a healthy democracy. The Minnesota Government Data Practices Act creates a *premise* that the government data is available to the general public unless otherwise established by a statute, law, or rule. With the exception of specified documents, the law regards *all* documents from public agencies to be government data.

Transparency is especially critical to the prudent management of trillions of dollars invested in America's state and local government pensions. Indeed, the single most fundamental defining characteristic of our nation's public pensions is *transparency*. Of all pensions globally, our public pensions—securing the retirement security of nearly 15 million state and local government workers,

Key Findings:

Minnesota officials block public access to pension data, as they aggressively target participants demanding transparency. Billions in undisclosed fees to Wall Street. $39 billion underperformance losses.

Performance claims reveal brazen benchmark bias that could have catastrophic tax consequences. Significant private investment and "Zombie" fund risks, as well as pension consultant conflicts of interest identified.

funded by workers and taxpayers—are required under our state public records laws to be the most transparent.

While transparency is widely accepted as "the right thing to do," there is ample evidence indicating greater transparency leads to better outcomes. On the other hand, forensic investigations reveal that greater secrecy inevitably leads to fraud, mismanagement and waste.

Transparency, which would add not a single dollar of additional cost to the Minnesota Teacher Retirement Association (TRA) or Minnesota State Board of Investment (SBI) could, through exposure, swiftly cure all that ails both pensions—highly suspect performance claims; massive undisclosed, excessive and potentially bogus investment fees and expenses; reckless risk-taking; unaddressed conflicts of interest, mismanagement and potential malfeasance.

Public pensions primarily invest government workers retirement savings in securities and funds which are regulated on both the federal and state level. Our nation's securities laws require that securities issuers and fund advisers register with regulators, disclose financial and other significant information to *all investors*—including public pensions—as well as prohibit deceit, misrepresentations, and other fraud. The statutorily mandated disclosure information is commonly provided to all investors in the form of prospectuses, offering memoranda, annual reports, performance reviews and other documents.

Thus, in public pension matters, we are concerned with two levels of transparency: Investment firms must be transparent in their dealings with *pension boards and staffs overseeing investments*, so these individuals can fulfill their fiduciary duty to diligently safeguard pension assets. Pensions, in turn, must be transparent *to the public* for stakeholders to understand the investment program, and, equally important, evaluate whether pension fiduciaries are prudently performing their duties.

Despite the primacy of public scrutiny, tellingly, there is no mention of, or commitment to *transparency* in TRA's Mission Statement.

Our investigation reveals TRA and SBI have long abandoned transparency choosing instead to collaborate with politicians, public pension industry insiders and Wall Street to eviscerate Minnesota public records laws and avoid accountability to stakeholders. Predictably, tens of billions that could have been used to pay state retirement benefits have been squandered as transparency has ceased to be a priority.

- **TRA Response to Public Record Request: Pension Has None**

As a result of TRA's confusing structure, the initial daunting challenge pension stakeholders seeking fundamental information regarding TRA's investments encounter is determining *who to ask, for what and how*.

On April 11, 2024, we submitted our initial public record request for information regarding TRA *to TRA itself* electronically.

In response, TRA admitted it does not have access to, or possession of, *any of the fundamental investment documents* we requested related to the pension's assets. As a result, clearly TRA's board *has not* over the years and, indeed, *cannot* fulfill its fiduciary obligations to review such investments for prudence. While TRA's handbook states its Board has "knowledge regarding pension investments," absent relevant documents and reports, the Board *cannot possibly* be knowledgeable as to TRA's specific investments. In reality, TRA's board exercises *no fiduciary oversight* of the trust's investments whatsoever. Any claims to the contrary are grossly misleading to pension stakeholders.

- **SBI Complete Failure to Respond to Public Record Request**

Given the lack of clarity regarding the governmental entity holding documents related to TRA's investments, we also requested the very same data from the Minnesota State Board of Investment—the entity which actually manages TRA's assets.

We received nothing.

Since early April, we have not been provided with *any* of the data requested regarding TRA's basic investment operations from TRA or SBI. We have not been informed SBI does not possess the data or that any of the data we requested are nonpublic.

The lack of cooperation by TRA and SBI was all-the-more surprising given that both pensions were well-aware that this forensic review was commissioned, as well as paid for, by thousands of participants, with the stated objective of improving management and oversight. Pension fiduciaries solely concerned with the best interests of participants and beneficiaries should welcome, not obstruct, a free independent review by nationally recognized experts. Further, given the profound concerns stakeholders have long raised, it is clear both pensions could benefit from an independent review by experts—this time not of their own choosing.

In conclusion, TRA claims it has *no data* to disclose regarding its investments and SBI has chosen to simply *not respond* to repeated requests for such data. Whether SBI even has the data requested is *unknown*.

As a result, it is simply impossible for stakeholders in Minnesota's state pensions (including participants and taxpayers)—no matter how sophisticated or diligent—to determine whether the assets in such funds are prudently invested, properly valued and safely custodied, *or even exist.*

In summary, despite any state laws mandating transparency:

Public pensions in Minnesota are not subject to public scrutiny.

- **TRA Records Participant Calls Without Consent; TRA and SBI Refuse to Record Board Meetings**

Finally, while teachers have long pressed the TRA Board to enhance transparency by recording its meetings (so that active teachers and other stakeholders who are unable to attend meetings held during the workday can be informed as to its dealings), audio recordings of such meetings were stopped at some point in the past supposedly on advice of legal counsel (apparently the Attorney General)—without explanation.

We note that public pension board meetings around the country are routinely recorded, both on audio and video and even broadcast live via audio web stream. There is simply no good reason TRA participants or stakeholders should be denied the opportunity to scrutinize Board actions through recorded meetings. Indeed, recording of the meetings would quickly expose that the TRA Board neither possesses nor reviews key information regarding the pension's investments. (We note that SBI also does not record its Board meetings to enhance transparency.)

While TRA will not record its own Board meetings, recent data provided by TRA pursuant to individual public record requests reveal the pension routinely records telephone conversations with participants—without notice or consent—and internally disparages participants critical of its operations, unbeknownst to them. Clearly, TRA and SBI opposition to recording their own Board meetings yet willingness to secretly record calls from, as well as comment upon participants is indicative of a culture of defensiveness and hostility toward stakeholders.

- **State and National Effort to Undermine Forensic Investigation**

Internal documents provided by TRA in response to an individual public records request reveal an aggressive, preemptive secretive effort on the national level—including state pension officials in California, New York, Ohio, Rhode Island and Minnesota, as well as education unions and public pension industry allies to undermine the participant-funded investigation. These efforts began as soon as the participant-funded investigation was openly proposed on GoFundMe but before it was *even funded*. As alarming as the documents provided are, other documents—presumably more damning—were withheld by TRA supposedly pursuant to the attorney-client privilege.

On the one hand, the documents reveal TRA and SBI staff and Board members, state legislators and officials (including the offices of Governor, Attorney General and Legislative Auditor) were panicked, believing the proposed investigation posed "many serious risks to the agency and pension fund. Specifically, TRA's reputation as a trusted government agency is going to be questioned." Further, these parties reasoned that since TRA does not manage its investments, the investigation would be focused on SBI which "invests assets for not just TRA, but the Minnesota State Retirement System, the Public Employees Retirement Association, volunteer fire relief plans, state cash accounts of over 400 state agencies, and the non-retirement program that provides investment options to state trust funds and various public sector entities. Therefore, all of those groups, entities, and entities' boards would be impacted" by the investigation. Anxious state officials proposed asking Education Minnesota, an organization made up of 477 local unions and 84,000 members, including active and retired teachers, "to publicly support TRA and the SBIs' integrity."

During the fundraising period, a member of the Facebook Group received a phone call from a TRA Board member who encouraged her to drop the effort. She also received phone calls from Retired Educators Association of Minnesota leadership "in an attempt to talk the Group out of the proposed investigation."

Once the investigation was under way, between June and August, Facebook Group members met with SBI CIO Jill Schurtz on 6 occasions and fielded her numerous phone calls and text messages. In those meetings and phone calls, Schurtz asked the Group to drop their public records request multiple times, and stated that they “didn't want their name associated with the investigator who took a "scorched Earth" approach in investigating wrongdoing.” Schurtz also stated that she would help set up meetings to connect the Group with key players in pension reform and offered to bring in an auditor to determine the normal cost of Tier I and Tier II pensions.

On the other hand, public pension organizations to which TRA and SBI pay membership dues and attend their lavish conferences at luxury venues—the National Council on Teacher Retirement and National Conference on Public Employee Retirement Systems—assured state officials that any investigative findings would be “a worthless big pile of opinions” and “lies.”

These allies organized Zoom meetings with pension officials in other states opposed to participant-initiated transparency reforms and secretly provided opposition research to media—specifically targeting reporters who had already met with members of the Facebook Group.

The self-proclaimed Minnesota Center for Fiscal Excellence publicly posted in a blog: “Our prediction right now is that this is going to turn up absolute bupkis, and that teachers contributing to this fund are wasting their money.”

When Minnesota officials, including the Governor, public pension boards and staff, representatives of State or Legislative Auditors, Attorneys General, legislators and public pension industry allies preemptively, aggressively target individuals who are working on behalf of pension participants to ensure *public scrutiny of public monies*—to undermine their reputations and investigations—the public should be very concerned. These schemes are rarely exposed but when they are (as in Minnesota), the public, regulators and law enforcement should ask:

Why did Minnesota government officials responsible for overseeing state pensions immediately assume an independent, expert review would uncover anything seriously wrong, e.g., mismanagement or wrongdoing? What did they know about the state's pensions that so worried them they were compelled to preemptively strike out?

- **TRA "Endangered" Funding Status**

According to its financial statements, TRA is *an administrator* (emphasis added) of a multiple employer, cost-sharing retirement fund which provides retirement, disability and survivor benefits to Minnesota's public educators. It is also stated that, for financial reporting purposes, TRA is considered a *pension trust fund* (emphasis added) of the State of Minnesota. Total plan assets of the TRA fund as of June 30, 2023 were $28.2 billion. For the fiscal year ended June 30, 2023, the funded ratio of the pension was 76.9 percent, a decrease from 82 percent a year earlier.

Under the federal scheme (i.e., Pension Protection Act of 2006) designed to address alarming funding problems encountered by many multiemployer corporate pensions, at 76.9 percent funded, TRA would be considered in the Yellow Zone for *endangered* and would be required to adopt a funding improvement plan designed to increase its funding percentage.

The investment return assumption used by TRA was reduced effective July 1, 2023 from 7.5 percent to 7 percent, as recommended by the actuary for the plan. The 2023 unfunded actuarial liability of the pension was $35 billion, an increase from $31.6 billion a year earlier. If the net pension liability were calculated using a discount rate which is one percentage point lower than the current assumption, i.e., a more realistic 6 percent rate, the current underfunding would soar to approximately $40 billion.

- **TRA Complex Structure Amounts to "Sleight of Hand"**

The state's $146 billion in public retirement fund assets, including TRA, are invested under the authority and direction of the SBI and are commingled in various pooled investment accounts, commonly referred to as the Combined Funds. TRA does not own any underlying assets, but instead owns a participation in the pooled Combined Funds. That is, each participating retirement fund owns an undivided participation in the Combined Funds' pooled investment accounts.

The Combined Funds structure creates unnecessary complexity, heightened risks and a profound lack of transparency.

Prudent practice dictates that pension assets be overseen by the plan sponsor, separately custodied and held in the name of the plan. Plan investment holdings should be clearly identified/disclosed to participants so that participants can judge for themselves whether the assets are suitable and properly managed.

Having TRA's assets custodied elsewhere, held in another plan's name, in opaque funds under the authority and direction of others amounts to a "sleight of hand." No reasonable participant would accept the additional risks to their retirement security the Combined Funds structure creates—assuming any participant could even understand the risks related to the Combined Funds.

Worse still, there are no benefits from the Combined Funds structure. While SBI claims that by pooling the assets, it can offer institutional investment management at a low cost, the available evidence indicates that the fund has increasingly embraced high-cost investment vehicles that fail to perform competitively. Potential economies of scale are not realized, as a result of mismanagement by SBI. *The Combined Funds structure has historically merely served to obscure, or conceal investment underperformance and facilitate underreporting of investment fees and expenses.*

TRA's assets are overseen by *three* different boards—TRA, SBI and the Investment Advisory Council (IAC), all of which are fiduciaries to the plan. TRA is governed by an eight-member Board of Trustees consisting of five elected representatives, one representative of the Minnesota School Boards Association, the Commissioner of the Department of Education, and the Commissioner of Minnesota Management and Budget. All members of the SBI Board are elected officials—the Minnesota Governor (who is designated as Chair), State Auditor, Secretary of State and Attorney General. The SBI governance structure is fundamentally flawed in that *none* of these politicians has any pension expertise and *all* may receive campaign contributions directly or indirectly from investment firms holding (or seeking) lucrative contracts to manage the massive state fund's assets. Indeed, the Chairman of the SBI Board, Governor Walz, according to recent financial disclosures has never owned a stock or bond. The legislature has also established a 17-member Investment Advisory Council (IAC) to supposedly advise the SBI and its staff on investment-related matters.

Remarkably, despite an apparent *abundance of board oversight*, even a cursory review of TRA and SBI reveals glaring, obvious deficiencies and inconsistencies which should have been identified and addressed years ago by one or more of the boards.

- **Failure to Monitor and Fully Disclose Skyrocketing Investment Fees and Expenses**

It is well established that sponsors of retirement plans have a fiduciary duty to ensure the fees their plans pay money managers for investment advisory services are reasonable. In turn, reporting investment results to pension stakeholders in both gross- and net-of-fee terms gives them a clear, easy way to view the impact of fees on fund performance.

However, neither TRA nor SBI disclose investment returns both gross- and net-of-fees to stakeholders. In our opinion, the only reason to report total returns on a net of fees basis only is to conceal the total fee amounts—fees which have skyrocketed in recent years.

Equally disturbing, SBI's Annual Reports include an unusual, prominent warning which indicates the pension has chosen to withhold important fee information from *its Board* because the pension mistakenly believes the Board should "focus" exclusively on net results, i.e., disclosure of investment fees and expenses would be a mere distraction. As a result of its "focus," apparently the SBI Board is *unaware* of the total amounts paid. (Since TRA financial statements do not include this same prominent warning, as well as other important disclosures included in SBI reports, TRA participants are less informed about its finances.)

The shift by public pensions, including TRA and SBI, into more complex, opaque so-called "alternative" investment vehicles, such as hedge, private equity and venture funds, as well as fund of funds has brought dramatically higher investment fees—fees which are often not fully disclosed and may be much more difficult for pensions to monitor.

Worse still, a recent review by the SEC found more than half of about 400 private-equity firms it examined charged unjustified fees and expenses without notifying investors.

Accordingly, pensions which choose to gamble in asset classes—such as private equity funds, specifically cited by regulators for charging bogus fees in violation of the federal securities laws—must establish heightened safeguards to ensure that all fees paid to such managers are properly reviewed and determined to be legitimate, as well as fully disclosed to participants.

- **Tens of Billions in Undisclosed Fees Paid by TRA and SBI to Wall Street**

In terms of *disclosed* investment management fees, each year for the past 11 years TRA's financial statements indicate a remarkably low and consistent amount—less than 10 basis points of total plan assets. More implausible, as the pension has invested a greater percentage of its growing total plan assets to high-cost alternative investments—an increase from $2.7 billion to $6.6 billion—disclosed fees have *fallen* and only fluctuated slightly from year-to-year. This is unbelievable since the fees and expenses related to private assets are well-known to be exponentially greater than those related to traditional assets. (Private funds annually charge substantial asset-based fees of approximately 2%, as well as performance fees of 20% or more.)

We note that a comprehensive study of 54 public pensions from 2008 to 2023 shows fees average 1 percent of assets under management. By that metric, TRA with $28 billion in assets would be expected to pay over a quarter billion dollars a year in fees to fund managers.

In our opinion, it is apparent that total investment management fees and expenses are *grossly underreported* annually by both TRA and SBI. The overwhelming majority of such fees are *not disclosed* to stakeholders.

It appears that only a small percentage—**less than 10%**—of the total fees have been disclosed to the public.

For example, in 2023, TRA disclosed total investment fees of merely $24 million. We estimate total fees related to TRA's private equity funds **alone** that year ranged from **$334 million to $467 million.** The *undisclosed* private investment fees in 2023 alone—in a single year—substantially exceed *all fees disclosed by the Fund since 2013* ($262 million).

Total TRA undisclosed private investment fees since 2013 amount to an estimated nearly **$3 billion.**

Like TRA, SBI discloses only a small amount ($83 million in 2023) of the total fees it actually pays Wall Street—an estimated **$1.7** billion to **$2.4 billion** annually.

Over the past decades, we estimate **tens of billions** in *undisclosed* investment fees have been paid by TRA and SBI to Wall Street. In our opinion, it is inconceivable, given public attention regarding the inadequacy of public pension investment fee disclosures and the numerous costly experts TRA and SBI have retained to advise them, the pensions are unaware of the massive fees they have failed to disclose in the past—even if they are clueless as to the exact amounts.

An exhaustive investigation into all TRA and SBI past payments to investment managers should be immediately undertaken, as well as recovery pursued with respect to any illegitimate or excessive payments. Given widespread industry abuses (as documented by SEC staff), and TRA and SBI failure to diligently monitor all investment fees and expenses, the likelihood of bogus charges is high, in our opinion. Finally, disclosure of historic costs should be adjusted to correct any past underreporting or errors.

- **$360 Million in Fees Paid Annually to Wall Street for Doing Nothing**

According to the Financial Statements, "TRA has a total of $3.6 billion in unfunded commitments to the investments valued at NAV. Unfunded commitments is money that has been committed to an investment but not yet transferred to the General Partner (Investor)." Whether TRA has any unfunded commitments related to any other investments, not included in the above figures, is unknown at this time.

Among the many controversial practices related to private equity and debt investing is charging investment management fees on "committed capital." In other words, after the investor makes a capital commitment to a private fund, management fees are charged on the entire commitment amount, regardless of whether the capital is actually drawn or invested. Paying fees on committed, uninvested capital results in exponentially greater expenses on assets under management on a percentage basis.

Fees on committed, uninvested capital amount to paying managers for *doing nothing*—no service whatsoever is provided in exchange for the outlandish fee. In our opinion, such fees add insult to injury since these types of alternative investment funds already charge exponentially higher fees than traditional stock and bond funds.

Not surprising, unlike TRA and SBI, savvy institutional investors are increasingly refusing to pay outlandish fees to private investment managers based upon their capital commitments and opting for alternatives that do not charge such fees.

Assuming TRA pays fees of 2 percent on total unfunded commitments, this amounts to an estimated annual waste of approximately **$72 million**.

As discussed earlier, there is no reason to believe TRA monitors or knows the full fees—including fees on committed, uninvested capital—it pays investments managers and whether those fees are fully disclosed.

Total fees on committed, uninvested capital paid by SBI would be *exponentially greater* than those paid by TRA, an estimated **$360 million** annually—for doing nothing.

- **TRA Brazen Benchmark Bias: $39 Billion Investment Underperformance**

According to TRA's financial statements for fiscal year 2023, performance versus a Composite Index (devised by TRA) indicates the fund has outperformed the Index on a 1, 5, 10, 20, and 30-year basis by 0.2% for each and every period. In our opinion, **this same 0.2% outperformance year-in and year-out seems virtually impossible.**

To determine the probability of getting five of the exact same return values relative to the Index—0.2%, data was obtained from SBI Annual Reports for the years 2014–2023. The probability of getting the same return value five times was calculated to be **0.0000149**. Notably, the exact same outcome of five return values of 0.2% **also occurred in 2020.**

The composition of the Composite Index devised by TRA is not disclosed in TRA's financial statements. Therefore, it is impossible to evaluate whether it is constructed appropriately to gauge performance of the portfolio. Further, absent such disclosure, it is impossible for stakeholders to determine *if, when or how* the Composite Index may have been changed over time.

SBI's Annual Report discloses the composition of its Composite Index for the period ending June 30, 2023 for the Public Equity Composite Benchmark and Fixed Income Composite Benchmark. No composite benchmark is disclosed for its highest cost, riskiest investments in Private Markets, including private equity, private credit, resources, and real estate. Later, the Report states SBI reviews the performance of its private market investments, relative to inflation, as measured by changes in the Consumer Price Index. Comparing private markets performance to the CPI's 2.5% annualized performance is not only *absurdly inappropriate* but *virtually ensures* that private markets (and the SBI as a whole) will handily outperform its Composite Benchmark. If SBI investment staff members are paid bonuses for outperforming the Composite Benchmark, they, too, will benefit.

The Public Equity Composite Benchmark disclosed is highly complex, has changed almost yearly since 2016 and was adjusted quarterly in certain years. Further, it is noted that “Prior to 6/30/2016 the returns for Domestic and International Equity were not reported as a total Public Equity return.” The Fixed Income Composite Benchmark is also complex and has been changed repeatedly since 2018. It is impossible for pension stakeholders to determine whether the composition of the shifting benchmarks is appropriate and whether benchmark performance has been calculated correctly.

In a recent article entitled *Lies, Damn Lies and Benchmarks: An Injunction for Trustees*, investment consulting pioneer Richard Ennis concludes that most public pensions, including Minnesota, exhibit benchmark bias when reporting their performance publicly.

In another article*, “Cost, Performance, and Benchmark Bias of Public Pension Funds in the United States: An Unflattering Portrait,”* Ennis analyzed the primary performance benchmarks used by 24 large public funds, including Minnesota, in their public reporting. These were benchmarks of the public funds’ own devising. He compared the rate of return of empirically-determined benchmarks to the return of the benchmark each fund reported in its annual report for the 10-years ended June 30, 2020, in order to determine benchmark bias.

In short, he identified *significant bias* in the returns of benchmarks used by the funds. With respect to Minnesota specifically, for the 10-year-period ended June 30, 2022, Ennis concluded the pension *underperformed* a representative passive benchmark by 0.26%. On the other hand, for the same period, TRA boasts it *outperformed* its Composite Index by .40%.

When we calculated the true performance of the $28 billion-plus pension using empirically-determined benchmarks, we determined TRA underperformance amounted to **$39 billion** over the past 30 years. In short, had the pension been prudently managed to its risk-adjusted benchmarks, it would be nearly **$60 billion** today—providing greater retirement security for participants and saving taxpayers billions.

In conclusion, representations that the Combined Funds have outperformed the Composite Index devised by TRA by **0.2%** for each and every period seem highly suspect. While experts have proven widespread benchmark bias at public pensions, TRA's remarkable claims of 0.2% consistent outperformance for all periods stand out. TRA's performance results amount to, at a minimum, **brazen benchmark bias.**

- **"Catastrophic" Tax Consequences of Pension Performance Errors**

When large public pension plans misstate their investment performance results—intentionally, or unintentionally—the tax consequences can be "catastrophic," according to tax experts.

In 2021, when internal documents at Pennsylvania's largest pension fund—the Public School Employees' Retirement System—revealed a performance calculation error, the FBI and SEC launched investigations, the fund's board began its own probe and 100,000 public school employees suddenly faced paying more into the retirement system. The error related to "data corruption" in just a single month—April 2015—over the near-decade-long period included in the performance calculation.

While the one-time error was small, it falsely boosted the $64 billion fund's performance over a financial quarter just enough to wrongly lift the fund's financial returns over a key state-mandated hurdle used to gauge performance.

The board had little choice but to fix the number. A top tax lawyer warned the board that failure to do so would be “catastrophic” and force half a million current and retired school workers to pay future income taxes on pensions immediately.

Since both TRA and SBI have failed to provide any of the documents we have requested, we cannot know for certain—and can only estimate—the magnitude of any potential errors or omissions in calculations of performance and investment costs. Further, we cannot know the tax consequences, or other legal and financial implications of any pension miscalculations.

However, with respect to TRA and SBI, the .02% outperformance is consistent over *all periods of time over 30 years*, not merely *a single month* in a near-decade-long period. Also, it is apparent that only a small percentage—less than 10%—of the total fees have been disclosed. Coincidentally, as discussed further below, the outside consultant ultimately found responsible for the error at the Pennsylvania pension was Aon—a consultant used by both TRA and SBI.

Finally, in recent years the Securities and Exchange Commission has brought securities fraud charges against the states of Kansas, Illinois and New Jersey stemming from a nationwide review of bond offering documents to determine whether municipalities were properly disclosing material pension liabilities and other risks to investors. Any potential pension performance or investment fee disclosures which are erroneous may be of concern to the SEC.

- **Private Investment Risks**

TRA and SBI have a 25% target allocation to private markets that includes private equity, private credit, real estate and resources. These are the highest-cost, highest-risk of all investments and the least transparent. Due to the heightened concerns regarding these assets, we specifically requested from both TRA and SBI all documents related to these funds.

Our goal in requesting the private market documents was to determine whether these investments were prudent and adequately monitored by pension fiduciaries. TRA responded that it had no such documents related to its alternative investments and SBI—without indicating whether it has any such documents—has provided none to date.

Nevertheless, the risks related to private market investments generally and commonplace industry abuses are well-known. In fact, many of the risks, conflicts of interest involving self-dealing and other abuses are regularly partially disclosed in the offering documents—documents which TRA and SBI have been unwilling or unable to provide to us.

In order to educate TRA and SBI stakeholders as to these risks and abuses, we have provided an initial list related to private equity investments. In our forensic investigations of over $1 trillion in retirement plans, we have never encountered a pension that fully understood the dangers of investing in alternatives and adequately monitored the investments. Clearly, TRA—which claims it does not hold any of the key investment documents cannot fully understand disclosures it has not even seen and monitor the risks consistent with its fiduciary duties. Whether SBI possesses, has reviewed and monitors these high-risk investments is unclear. However, the fact that the pension is, at best, unwilling to release to the public any documents it may have, is alarming.

- **"Zombie" Fund Dangers**

According to TRA, "the typical liquidation period for alternative investments ranges from 3 to 12 years." When alternative investments fail to fully liquidate within the stated term of the fund, numerous concerns arise, including whether some or all investment fees will continue to be charged, as well as whether the valuation of portfolio investments and performance reporting has been accurate over the life of the fund.

For example, following the wreckage of the 2009 global financial crisis, many private equity managers (unable to raise new capital because of poor performance) extended the lives of their troubled funds, milking management fees from investors for mediocre and over-leveraged assets for years. These funds were referred to as "Zombie Funds" by the financial press. Major public pensions have been found to be at risk from Zombie funds. A new class of Zombie funds is reportedly emerging today due to the sharp rise in interest rates.

According to TRA's financial statements, there are 45 out of 193 Private Equity funds owned by SBI that are over the 12-year liquidation and represent 6% of the Private Equity NAV value. There are 8 out of 35 Real Estate funds owned by SBI that are over the 12-year liquidation and represent 1.2% of the Real Estate NAV value. There are 12 out of 32 Real Assets funds owned by SBI that are over the 12-year liquidation and represent 13.2% of the Real Assets NAV value. There are 13 out of 42 Private Credit funds owned by SBI that are over the 12-year liquidation and represent 7.1% of the Private Credit NAV value.

In conclusion, TRA and SBI alternative investments subject to extended liquidations should be examined more fully. There is ample reason to believe, in the opinion of experts, that the delayed liquidations may be "red flags" for abusive practices, including, but not limited to, fraudulent valuations.

- **Failure to Monitor Pension Consultant Conflicts of Interest**

Today it is well established that conflicts of interest involving investment consultants retained to provide objective advice to pensions regarding asset allocation, manager selection and performance monitoring are pervasive throughout the industry. Such conflicts, including but not limited to the receipt of compensation directly or indirectly from investment managers they recommend to pensions, can result in substantial financial harm to pensions. As a result, regulators including the Department of Labor and SEC, have advised plan sponsors they have a duty to investigate such conflicts.

Our review of relevant regulatory filings and disciplinary histories reveals all three of the investment consulting firms TRA and SBI utilize are subject to significant potential conflicts of interest. Since TRA and SBI have failed to provide us with any contracts between the funds and their investment consultants, stakeholders cannot possibly know critical facts such as the range of services the firms provide, whether the firms have adequate insurance coverage to satisfy potential claims involving the massive pensions and whether the pensions have agreed to any limitations on investment consultant liability. Stakeholders cannot possibly determine whether the products and services the investment consultants offer to money managers, and related compensation, which can give rise to serious potential conflicts of interest have been adequately disclosed to plan fiduciaries and are monitored on an ongoing basis.

If TRA and SBI's investment consultants have failed to properly disclose to the pensions, conflicts of interest and investment manager compensation arrangements, they may have both failed to comply with their advisory contracts, as well as violated statutory fiduciary duties. If TRA and SBI have failed to adequately monitor conflicts of interests involving their investment consultants which could potentially undermine the integrity of the pensions' investment decision-making process, the Boards may have breached their fiduciary duties to safeguard assets and exposed the funds to enormous risks. Further, the TRA and SBI Boards may have permitted the investment consultants to enrich themselves by the amounts of such manager payments, at the expense of the pension.

- **Conclusion**

In light of the serious ongoing concerns identified, it is generally advisable for stakeholders to contact the State Auditor, Legislative Auditor and Attorney General. However, in this matter, all three of these state offices are potentially conflicted.

The State Auditor is a member of the SBI board. Further, according to the office, her "authority does not extend to TRA or other agencies audited by the Legislative Auditor." It appears that stakeholders could contact Office of Legislative Auditor (OLA) regarding the statutory authority and process for a petition or *special audit.* According to OLA, allegations of misuse of state money, resources or data, can be the basis of a special review. Petitioning OLA to essentially audit its prior TRA work might be worthwhile in light of the compelling new information in this report.

Finally, this report was filed with the SEC and provided to the FBI. While the Attorney General appears to be conflicted in this matter due to his involvement with the pensions (as TRA legal counsel and SBI Board member) and having opposed the investigation, he was provided a copy of our findings.

End Executive Summary

II. Introduction

- **Minnesota Educators for Pension Reform Facebook Group Commissions Independent Expert Forensic Investigation of TRA**

Through a grassroots GoFundMe campaign that commenced on February 25, 2024, 2797 members of the Minnesota Educators for Pension Reform Facebook Group raised $78,373 to engage Benchmark Financial Services, Inc. ("Benchmark") to conduct an independent expert forensic review of TRA on behalf of pension participants. That is, each contributor paid approximately $28.00 for the expert review.

According to members of the Facebook Group:

The decision to crowdsource an external investigation was driven by lack of advocacy; lack of transparency; and lack of trust. TRA members have been involved in and begging for equitable Tier II pension advocacy and reform from our own union, legislators, and TRA for the past two years. Not only has there been limited reform during that time, but TRA actively advocated against reform in the legislature. In response to the lack of advocacy, members began asking for general information, improved transparency of communications, and specific documents. These requests have been ignored and denied. As a result of the lack of advocacy and lack of transparency, thousands of members now feel justified in stating that we have lost trust in a system that was allegedly tasked with protecting our retirement security. Examples include:

1. Repeated board action taken to ensure that Tier I benefits are preserved or improved.
2. Board allowed the legislature to damage Tier II benefits through punitive legislation. (Excessive penalties and removal of deferred augmentation).
3. Manipulated elections for the retired TRA member seat.
4. The board's refusal to disseminate information.
5. The board's refusal to hold meetings when members could attend.
6. The board's refusal to record meetings.

7. The board's refusal to cost out proposed pension plans to be brought to the Minnesota state legislature.
8. The board actively tried to kill proposed bills for pension improvement with legislators.
9. The board's refusal to collaborate with the teachers' union for improved pension benefits.
10. General lack of advocacy for Tier II members.

- **State and National Efforts to Undermine Forensic Investigation**

Internal documents provided by TRA, SBI and the Attorney General's office in response to individual[1] public records requests revealed an aggressive, preemptive secretive effort—on the national level, including state pension officials in California, New York, Ohio, Rhode Island and Minnesota, as well as education unions and public pension industry allies—to undermine the participant-funded investigation into potential mismanagement and malfeasance. These efforts began as soon as the investigation was proposed but *before it was even funded.* As alarming as the documents provided are, other documents—presumably more damning—were withheld supposedly pursuant to the attorney-client privilege.

The following is a summary of one of the first of a series of documents obtained from TRA through an individual public records request.[2]

[1] As noted below, in Minnesota individuals are entitled to data regarding *themselves* within 10 days. Accordingly, on May 24th, we separately requested from TRA "any documents, records, emails you have related to Edward Siedle…" On June 20th, we requested this same individual information from SBI. While neither TRA nor SBI—despite repeated reminders—responded within the statutory period of 10 days—the funds eventually did separately provide dozens of damning documents. Curiously, SBI provided less documents than TRA and, somehow, failed to provide SBI documents which TRA provided to us. An individual public records request was also filed with the Attorney General.

[2] We are making *all* documents we received from TRA, SBI and the Attorney General's office related to individual requests available to the public.

On March 11, 2024, Jay Stoffel, the Executive Director of TRA blasted out an email entitled “An Important Matter” to all trustees of the TRA Board and staff. This same alarming email would, within days, be sent by him to Minnesota state legislators and officials—including the offices of Governor Walz, the Attorney General and Legislative Auditor—as well as officials of other states and private industry allies.

A “situation” posing “many serious risks to the agency and pension fund” had arisen which they “should be aware of and concerned about,” Stoffel wrote.

“I want to update you on the recent crowdsourcing effort of a group of teachers to raise $75,000 to pay… for an investigation… At this point in time, the group has raised $57,259,” warned a nervous Stoffel.

“As trustees of the TRA Board, it is important for you to be aware of and concerned about risks to the agency and the fund, and this situation poses many serious risks. Specifically, TRA’s reputation as a trusted government agency is going to be questioned.”

Stoffel went on to explain the serious *systemic risks* he foresaw from an independent expert review:

“As a Minnesota state agency, TRA is subject to multiple oversight controls.

TRA is audited by two outside auditors, the Office of the Legislative Auditor and CliftonLarsonAllen (CLA). TRA has an internal audit department. MMB reviews TRA’s budget and expenditures and TRA staff are subject to MMB policies and collective bargaining agreements. The Legislative Commission on Pensions and Retirement, comprised of 7 Senators and 7 Representatives, exists to oversee and review pension related legislation. TRA is governed by a board of trustees who are fiduciaries, and is required to comply with statutes, which contain all plan provisions, including benefits and contribution rates. The TRA Board retains an actuarial firm to annually evaluate the financial condition of the pension plan and the adequacy of contribution rates. Finally, TRA and the TRA Board receive legal guidance from the Attorney General’s Office on a multitude of issues, including the Open Meeting Law and Data Practices.

Further, the risks are not just to TRA, but the State Board of Investment (SBI)."

Reasoned Stoffel:

"In researching Mr. Siedle, the reports he has issued on other pension plans are focused on the investments of the plan. As TRA does not manage its investments, Mr. Siedle's inquiries likely will be focused on SBI. SBI invests assets for not just TRA, but the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA), volunteer fire relief plans, state cash accounts of over 400 state agencies, and the non-retirement program that provides investment options to state trust funds and various public sector entities. Therefore, all of those groups, entities, and entities' boards will be impacted by this movement."

In short, any potential mismanagement or wrongdoing uncovered through the participant-led expert investigation could have broad implications for Minnesota state government—including Governor Walz and other pension board members, legislators, the Attorney General, actuaries and auditors, in Stoffel's opinion.

Stoffel went on to enlist others in private industry—across the nation—to support his dire warnings:

"Leigh Snell, the Federal Relations Director from the National Council on Teachers Retirement (NCTR), wrote the attached article. The article focuses on Mr. Siedle's background and provides feedback on Mr. Siedle's report on the State Teachers Retirement System of Ohio (Ohio STRS), which is mentioned in the above GoFundMe description. Please note the serious issues Mr. Snell highlights with regards to Mr. Siedle's report of Ohio STRS..."[3]

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[3] Among the misstatements in Stoffel's email blast, he initially erroneously indicated that "the Executive Director of the Ohio STRS had been fired." Stoffel later corrected himself stating "I was wrong… he lost a vote of confidence by the Board. I recalled reading about this but mischaracterized it in our meeting. Sorry for the confusion." Later, he again misrepresented the facts stating, "the Ohio STRS Executive Director remains on paid administrative leave *as a result of Mr. Siedle's involvement* (emphasis added)." According to published reports, the Ohio Executive Director had been on paid leave for almost a year amid complaints of misconduct alleging sexual harassment, verbal abuse and threats of violence against staff. In short, the Executive Director's leave and eventual, recent dismissal had absolutely *nothing* to do with the Benchmark forensic investigation of Ohio STRS. https://www.pionline.com/pension-funds/ohio-state-teachers-retirement-system-executive-director-bill-neville-dismissed-board

TRA also provided a full copy of Snell's 5-page oppositional research written and distributed by the National Council on Teachers Retirement to its members.

Again, Stoffel wasn't just warning his own Board and staff about this dangerous participant "movement" for pension transparency and accountability. In his first email, he went on to say:

"We have met and spoken with legislative leadership, SBI staff, and others in leadership roles who could be affected by this movement."

Other emails reveal Stoffel discussed his concerns about the proposed investigation and strategies with Jill Schurtz, Executive Director and Chief Investment Officer of SBI.

Stoffel trumpeted his beliefs about the risks related to this proposed participant-led investigation into potential mismanagement and wrongdoing to seemingly anyone who had any responsibility for public pensions nationally (as well as private industry allies) in an effort to undermine the reputation of the investigator and credibility of the investigation—before the first word of any report had even been written.

Stoffel later sent this same disturbing email to Simone Frierson in Governor Walz's office; Patty Hand, Chief Operating Officer at the Minnesota Department of Education; Thomas Carr, Executive Budget Officer at the State of Minnesota, as well as Joseph Weiner, Division Manager Office of Minnesota Attorney General and Legislative Auditor Judy Randall. This time, Stoffel added to his email:

"We think it would be helpful and appropriate for Education Minnesota to publicly support TRA and the SBIs' integrity. This effort poses a true reputational risk and will only distract from efforts to strengthen the TRA pension fund and member benefits."

Asking Education Minnesota, an organization made up of 477 local unions and 84,000 members, including active and retired teachers, "to publicly support TRA and the SBIs' integrity" *before a proposed investigation even began* reveals desperation, in our opinion.

On March 13—two days after Stoffel's alarming email blast—a member of the Facebook Group received a phone call from a TRA board member who encouraged her to drop the fundraising effort. That same Facebook Group member also received phone calls from Retired Educators Association of Minnesota leadership in an attempt to talk the Group out of the GoFundMe project.

Once the investigation was under way, between June and August, Facebook Group members met with SBI CIO Schurtz on 6 occasions and fielded her numerous phone calls and text messages. In those meetings and phone calls, Schurtz asked the Group to drop the public records request multiple times, and stated that they "didn't want their name associated with the investigator who took a "scorched Earth" approach in investigating wrongdoing." She also stated that she would help set up meetings to connect the Group with key players in pension reform and offered to bring in an auditor to determine the normal cost of Tier I and Tier II pensions.

In short, the documents reveal TRA and SBI staff and Board members, state legislators and officials, including the Attorney General, believed the proposed independent, expert investigation posed "many serious risks to the agency and pension fund. Specifically, TRA's reputation as a trusted government agency is going to be questioned."

On the other hand, public pension organizations to which TRA and SBI pay membership dues, as well as attend their lavish conferences at luxury venues—the National Council on Teacher Retirement (NCTR) and National Conference on Public Employee Retirement Systems—assured state officials that any investigative findings would be a worthless "big pile of opinions" and "lies."[4]

[4] TRA is a longstanding member of NCTR. Indeed, former TRA board members have been honored by NCTR for their participation in NCTR. TRA regularly includes in its Annual Report a Recognition

In an email from Leigh Snell to Jay Stoffel dated March 5th:

Jay,

Dean just told me the ugly news about Ted Siedle going after your plan.

Ugh.

I have covered Siedle for quite some time. Most recently, he has been active in Rhode Island trying to "crowd source" an investigation of the plan's actions and their impact on COLA's. I believe his last major attack on a plan was in Ohio in 2021, and I did a special report in 2023 that tried to really expose his shenanigans as well as cover both the Ohio State Auditor's examination of his so-called "forensic audit" as well as the Ohio Teachers Plan's review. I included, where I thought it was appropriate, other activities by Siedle in Florida and elsewhere. At the time I wrote this, both NCPERS and the National Public Pension Coalition (NPPC) were also looking at him. I will see what I can find if they dug up anything you can use.

Award for Administration presented by the Public Pension Coordinating Council, which is comprised of NCTR, NCPERS and the National Association of State Retirement Administrators. The award is supposedly "in recognition of meeting professional standards for plan administration as set forth in the Public Pension Standards." TRA regularly pay tens of thousands of pension dollars for its officials to travel to and attend lavish NCTR conferences held at luxury venues. It is widely known that Wall Street firms pay exponentially greater fees to NCTR and NCPERS than state pension officials to sponsor and attend NTCR and NCPERS conferences—all for the opportunity to pitch their investment products and services to public pension officials.

As NCTR advertises on its website:

Interested in Partnering with NCTR?
Becoming an NCTR event sponsor gives you the opportunity to be in a face-to-face environment where you can network and increase market visibility. Gain the competitive advantage, while making direct connections with high-level decision makers from more than 63 public pension systems from across the nation, with combined assets exceeding $2 trillion in their trust funds.
https://nctr.org/upcoming-events/annual-conference/

So controversial are these conferences that the website for the 2013 National Conference on Public Employee Retirement Systems held on the famed beaches of Waikiki, supplied board members hoping to shore up support for their expenses-paid trip a "2013 Attendance Justification Tool Kit." The site also included "7 Tips for Building Your Case for Attending the Annual Conference," which suggests that trustees emphasize how the conference could help them "build a networking list" and identify ways to help "save your fund money." http://www.plansponsor.com/NewsStory.aspx?Id=6442463934

NCPERS is also involved in selling insurance products to public employees, including TRA members, in Minnesota. https://mnpera.org/wp-content/uploads/Employer_Newsletter_Q1Y23.pdf

The folks who are hiring Siedle need to understand that all they will get for their money is a big pile of his opinions, which are not worth much more than the paper they are written on. Also, he simply lies about plans' cooperation with him and about what he thinks they are up to. He has made millions on his whistle-blowing gig, and he can afford to do these investigations without the $5 and $10 dollar contributions of public pension retirees!! They can read his Ohio "audit" and the one he did of the Jacksonville FL Police and Fire Plan[5] and save their money. I guarantee the one he does of your plan will look just the same!!

Good luck, Jay! Please let me know if there is anything else I can do to help!

Minnesota officials and their allies organized Zoom meetings with pension officials in other states fearful of participant-initiated forensic investigations into potential mismanagement and wrongdoing.

In a March 19th email from Snell to Stoffel:

Thanks, Jay. Glad it helped. Hank Kim also hosted a Zoom call yesterday concerning "opposition research" on Siedle, and I will be working with NRTA and NEA on a generic education piece that can be used by national organizations to hopefully "inoculate" retirees to Ted's pitch when he comes calling. At this point, the plan is to be pretty generic, and we may not even mention his name but perhaps refer to "forensic audits" and other such "plan research." I realize that won't really help you, but it may help other plans down the road.

As for a letter to you, would you mind sharing the media inquiry you received as it may give me an idea of what the press is seizing on that we may want to be sure to address. Also, can you give me an idea as to how you plan to use an NCTR letter?

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[5] The 2015 Jacksonville Police Pension investigation was commissioned by the City of Jacksonville after state Representative Janet Adkins sent a letter to Florida Governor Rick Scott requesting the governor assign his inspector general and the Florida Department of Law Enforcement to look into the Fund's operations to determine if any state laws or regulations had been broken. Among the Key Findings were: (1) Board failed to scrutinize conflicts of interest related to, and compensation disclosed, as well as received, by its General Counsel and other law firms; and (2) Allegations of waste, abuse and ethics violations regarding Board and staff travel should be resolved by limiting frequency, purpose and range of travel. Specifically, excessive travel to lavish industry conferences was a concern. As detailed in the report, the fund's General Counsel had also served as general counsel for more than 15 years to the National Conference of Public Employee Retirement Systems (whose conferences multiple trustees frequented.) https://www.jacksonville.gov/city-council/docs/currentissues/ci-pensionreform-2015-10-28-pfpf-forensicauditkeyf.aspx

Widely distributed to your membership and the press? Targeted use with policymakers? Both? Finally, should it be addressed to you or to your Board? Or both? I need to finish up my FYI for this week, and I have a planning call tomorrow for my upcoming webinar on A.I. next week. However, I plan to start on a letter tomorrow and hopefully get something to you by the end of the week.
Hang in there!!

On March 24th, Jill Schurtz, CIO of SBI, asked Snell for assistance with certain reporters she had learned (from monitoring the Facebook Group) were already talking with the Facebook Group members. Schurtz wrote:

The four TRA members who raised funds for the Ted Seidel engagement posted the update below to their Facebook page. Of particular note, they state that they will be speaking with a reporter from P&I online on Monday. I was wondering if it would make sense to provide background information to P&I? I'm guessing you may have the right contacts?

Would appreciate any guidance you could share.

On March 25th, Snell assisted Schurtz at SBI by contacting reporters at Pensions & Investments:

The ball is rolling. I have connected with Erin, who wants to talk tomorrow AM. I shared my "Special Report" (see attached) on Ted from last year with her for background purposes only. All I intend to do is make sure Erin understands what he has done in the past, and it will all be "on background." Don't plan to really discuss TRA issues and will defer to you guys on that if that works for you. I have also talked with my friend Hazel Bradford with P&I, who has also reached out to Erin and warned her she needs background before talking with Ted. I have also asked Keith Brainard with NASRA if he wants to join the call with Erin.
Hope this works with all of you.

To which Schurtz responded:

Leigh - that sounds like a good idea. Before we speak with P and I, all the MN folks on this email will connect in the morning (we're all at the same LCPR meeting) to make sure we're on the same page with taking this step.
Very grateful for your support!

Since Schurtz and Leigh's intervention between Pensions & Investments reporters and Facebook Group in March, the trade publication has not written any article about the unprecedented, newsworthy participant funded investigation of the state pension system—despite the fact that members were interviewed and asked to provide their pictures. On the other hand, this month, Schurtz was named an honoree in Pensions & Investments' 2024 Influential Women in Institutional Investing program.[6]

Finally, the self-proclaimed Minnesota Center for Fiscal Excellence publicly posted in a blog during the fundraising period: "Our prediction right now is that this is going to turn up absolute bupkis, and that teachers contributing to this fund are wasting their money."[7]

When Minnesota officials, including the Governor, public pension boards and staff, representatives of State or Legislative Auditors, Attorneys General, legislators and public pension industry allies preemptively, aggressively target individuals who are working on behalf of pension participants to ensure public scrutiny of public monies—to undermine their reputations and investigations—the public should be very concerned. These schemes are rarely exposed but when they are (as in Minnesota), the public, regulators and law enforcement should ask:

1. Why did Stoffel and his colleagues in government responsible for overseeing pensions in the past decade-plus immediately assume an independent, expert review would uncover anything seriously wrong, e.g., mismanagement or wrongdoing?
2. What did they know about the state's pensions that so worried them they were compelled to preemptively strike out?
3. How long has any pension mismanagement or wrongdoing—known to them—been going on?

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[6] https://www.pionline.com/influential-women-institutional-investing/minnesota-state-boards-jill-schurtz-named-pis-2024-class

[7] https://fiscalexcellence.org/page/teacherforensicpension

4. How much has any mismanagement or wrongdoing cost stakeholders—including participants and Minnesota taxpayers—over the decades?
5. Who stands to lose if the facts are exposed?

- **Benchmark's High-Impact Limited Forensic Review**

Benchmark has conducted a high-impact, limited preliminary forensic review of the pension. The purpose of a high-impact limited forensic review is to readily identify—at a substantially reduced cost—deficiencies which, if addressed, would significantly improve investment management and performance results.

As noted earlier, our requests for key documents from TRA and SBI were completely rejected. As a participant-funded review, we had limited opportunity to communicate with or interview people directly associated with either pension. Indeed, the two pensions communicated with other state officials, pensions and interested parties to thwart our investigate efforts. Person associated with the pensions sought to discourage participants from funding the investigation.

We believe that our expert findings are credible and our recommendations, if followed, would result in significant improvements. In the likely event that TRA, SBI or their vendors disagree with our opinions and are willing to fully disclose all the relevant documents, we welcome the opportunity to review the totality of the relevant information. We reserve the right to change our findings in the event that additional information should be forthcoming. This report should be read and evaluated with several caveats in mind. First, many of the subjects addressed in this report are inherently judgmental and not susceptible to absolute or definitive conclusions. We assumed the information we were provided, whether by the service providers, TRA or SBI is accurate, and could be relied upon. We were not hired to detect or investigate fraud, concealment or misrepresentations and did not attempt to do so. We were not hired to, and did not attempt to conduct a formal or legal investigation or otherwise to use judicial processes or evidentiary safeguards in conducting our review. Our findings and conclusions are based upon our extensive review of limited documents, independent analysis, and our experience and expertise. This Report does not and is not intended to provide legal advice. Although the report considers various legal matters, our analysis, findings and recommendations are not intended to provide legal interpretations, legal conclusions or legal advice. For that reason, action upon such matters should not be taken without obtaining legal advice addressing the appropriate statutory or regulatory interpretation and legal findings regarding such matters. Finally, our observations are necessarily based only on the information we considered as of and during the period we performed our review.

Where compelled (due to the potential of ongoing harm), we reported our preliminary findings to law enforcement and regulators.

III. Lack of Transparency

U. S. Supreme Court Justice Brandeis once famously said, “Sunshine is the best disinfectant.” In other words, transparency ensures that public officials act visibly and understandably, and report on their activities to the populace. Transparency in government has long been acknowledged in America as essential to a healthy democracy. The Freedom of Information Act (FOIA) enacted in 1967, opened up the workings of the federal government to public scrutiny, giving citizens information they need to evaluate and criticize government decision-making. All 50 states also have public records laws which allow members of the public to obtain documents and other public records from state and local government bodies.[8]

[8] http://foiadvocates.com/records.html

- **Minnesota Open Records Law Presumption of Transparency**

Each state has laws governing public access to governmental records. These laws are sometimes known as open records laws, public records laws, or FOIA laws after the federal statute. These FOIA laws define the procedures members of the public can use to access records.

There are time limits within which a public body must respond to a FOIA request as mandated by the laws in each state.

Response times vary by state, and some states do not specify a required time for a public agency to respond to a FOIA request. In the latter case, the statutory language often only says that responses must be prompt, or be made within a reasonable amount of time. For states with response time limits, there can either be a single limit or a range of response times based on certain circumstances. Obviously, lack of a mandated response time delays public scrutiny.[9]

As noted in this report, Minnesota has no response time for public records requests. However, with respect to the rights of *individuals* on whom the data is stored, the response time is 10 days.[10]

In Minnesota, the law governing the release of public records is referred to as the Minnesota Government Data Practices Act (MGDPA).[11] Enacted in 1974, the MGDPA sought to increase the transparency of the workings of government agencies without compromising individual privacy concerns. The MGDPA creates a *premise* that the government data is available to the general public unless otherwise established by a statute, law, or rule. With the exception of specified documents, the law regards *all* documents from public agencies to be government data. This

[9] https://ballotpedia.org/FOIA_request_response_times_by_state

[10] https://www.revisor.mn.gov/statutes/cite/13.04

[11] https://www.revisor.mn.gov/statutes/cite/13.02

includes information that is written, printed, digitized, recorded on tape or microfilm collected, maintained, or disseminated by government entities, regardless of form or storage media.

- **Public Pension Transparency**

Transparency is especially critical to the prudent management of trillions of dollars invested in America's state and local government pensions. Indeed, the single most fundamental defining characteristic of our nation's public pensions is *transparency*. Of all pensions globally, our public pensions—securing the retirement security of nearly 15 million state and local government workers, funded by workers and taxpayers—are required under our state public records laws to be the most transparent.

While transparency is widely accepted as "the right thing to do," there is ample evidence indicating greater transparency leads to better outcomes. In the words of one commentator, greater public pension transparency leads to:

1. Improved decision making. Transparency and accountability go hand in hand.
2. Clarity of purpose that comes from simplifying and communicating complex issues.
3. Improved relationships with a broad spectrum of stakeholders including beneficiaries, plan sponsors, regulators, suppliers, and concerned citizens.
4. Improved stewardship. After all, management's duty is to do their best to the benefit of their stakeholders.[12]

On the other hand, our forensic investigations reveal that greater secrecy inevitably leads to fraud, mismanagement and waste.

Transparency, which would add not a single dollar of additional cost to the TRA or SBI would, through exposure, swiftly cure all that ails both pensions—highly suspect performance claims; massive undisclosed,

[12] https://cembenchmarking.com/gptb.html

excessive and potentially bogus investment fees and expenses; reckless risk-taking; unaddressed conflicts of interest, mismanagement and potential catastrophic tax consequences.

- **State and Federal Securities Laws Also Demand Transparency**

Public pensions primarily invest government workers retirement savings in securities and funds which are regulated on the federal and state level. Our nation's securities laws require that securities issuers and fund advisers register with regulators, disclose financial and other significant information to *all investors*—including public pensions—as well as prohibit deceit, misrepresentations, and other fraud. The statutorily mandated disclosure information is commonly provided to all investors in the form of prospectuses, offering memoranda, annual reports, performance reviews and other documents. It is axiomatic that, at a minimum, investment information which must be disclosed to all investors under the federal and state securities laws, must be provided to stakeholders in public pensions subject to public records disclosure requirements.

After all, public pension stakeholders are the "investors" whose money is at risk.

To allow investment firms and public pension officials to use state public records laws to thwart securities disclosure requirements—concealing potential fraud and mismanagement from stakeholders, regulators and law enforcement—would make no sense. Indeed, public pension stakeholders should enjoy the *enhanced disclosure* and other benefits powerful, large institutional investor fiduciaries routinely negotiate—*disclosure above and beyond that provided to ordinary retail investors.*

Thus, in public pension matters, we are concerned with two levels of transparency: Investment firms must be transparent in their dealings with *pension boards and staffs overseeing investments*, so these individuals can fulfill their fiduciary duty to diligently safeguard pension assets.

Pensions, in turn, must be transparent *to the public* for stakeholders to understand the investment program, and, equally important, evaluate whether pension fiduciaries are prudently performing their duties.

- **TRA Lack of Commitment to Transparency**

TRA's Mission Statement[13] lists among its Goals:

Engagement and Education- TRA will provide information to empower members, employers, legislators and taxpayers to be aware and engaged about TRA's governance structure as well as the value of a defined benefit plan. Member educational materials should be clear, accurate, accessible and presented in innovative ways for all life stages.

However, there is no mention of, or commitment to *transparency* in the Mission Statement. Of course, transparency is critical to any education effort. If members are not permitted to see or review information which clearly and accurately details how their retirement assets are invested and the related costs, they can neither be engaged nor educated.

As discussed more fully below, our investigation reveals TRA has long abandoned transparency, choosing instead to collaborate with politicians, public pension industry insiders and Wall Street to eviscerate Minnesota public records laws and avoid accountability to stakeholders. Predictably, tens of billions that could have been used to pay state retirement benefits have been squandered as transparency has ceased to be a priority.

- **TRA Public Records Request Response: Pension Has None**

As a result of TRA's confusing structure—a subject which will be discussed frequently through this report—the initial daunting challenge pension stakeholders seeking fundamental information regarding TRA's investments encounter is determining *who to ask, for what and how*.

[13] https://minnesotatra.org/wp-content/uploads/2023/12/FY23-ACFR-Report.pdf

On April 11, 2024, we submitted our initial public record request for information regarding TRA *to TRA itself* electronically. We asked for the following basic operational documents and analyses:

For the past six years, please provide the following documents related to the TRA pension trust and its assets:

1. Please provide copies of any investment consulting contracts related to the TRA fund and any of its investment consultants, including traditional and alternative investments such as private equity, hedge funds and real estate.
2. Please provide copies of any investment consultant analyses, performance reports, due diligence reports and other information related to the fund.
3. Please provide copies of any analyses of direct and indirect investment management and other investment-related fees and expenses, including asset-based and performance fees, fees on committed, uninvested capital, operating and organizational fees and expenses.
4. Please provide copies of any audits or reviews of investment fees by any third party.
5. Please provide copies of any documents related to actual or potential violations of law involving any investment manager or other vendor to the fund.
6. Please provide copies of any investment advisory contracts related to the fund.
7. Please provide the offering memorandum, subscription agreement and/or investment advisory contract related to each alternative investment (including hedge, real estate, private equity and venture capital funds) in which the fund has invested, including any investment advisory fee waivers or other documents (such as side letters) amending or altering the applicable terms and/or fees.
8. Please provide any documents related to the payment of placement agent fees by the fund or its investment managers.
9. Please provide any contracts between the fund and any custodian banks.
10. Please provide copies of any communications or correspondence with the Securities and Exchange Commission related to the fund, or its assets or its investment managers.

On May 24, 2024, we received an email from Rachel Barth, Legal and Legislative Director at TRA indicating that it was in response to the data request we submitted on April 11th. The email included a ShareFile document which stated:

This email includes a link that will provide access to six years (72 documents) of monthly portfolio updates that TRA receives from the State Board of Investment. In order to access the documents, you will need to create an account with ShareFile. The link will expire after two weeks, please take note of the expiration date provided. You can find TRA's current and past Annual Comprehensive Financial Reports, which includes funding and investment information, here: https://minnesotatra.org/financial/annual-reports/

TRA does not have any other data responsive to your requests.

In short, for some reason it had taken TRA over a month to acknowledge it had *none* of the documents we requested and refer us to its publicly available (online) annual reports. The response we received was alarming in that TRA admitted it had no access to, or possession of, any of the fundamental investment documents related to its investments—other than information provided by SBI, which may or may not be accurate. Most disturbing was the fact that since TRA had none of the related investment documents, it could not possibly determine whether the information in the summary reports (monthly portfolio updates) provided by SBI, e.g., regarding fees and performance, was accurate.

We responded to this startling turn of events with a follow-up emailed question:

To be clear: TRA does not have any other data responsive to our requests.

To which Attorney Barth responded:

That is correct. TRA is the state agency that administers the pension benefits. The State Board of Investment is the state agency that invests the assets of state and local employee benefits plans, other public retirement savings plans, tax advantaged savings plans, and non-retirement assets.

Barth's response is incorrect or, at a minimum, significantly incomplete. TRA is not merely an administrator of a retirement plan for Minnesota educators. TRA is, according to its financial statements, a pension trust fund under Minnesota law. TRA has a board of trustees which has a fiduciary duty to oversee the pension trust.

Since TRA admits it does not have access to, or possession of, *any of the fundamental investment documents* related to the pension's assets, clearly TRA's board *has not* over the years and, indeed, *cannot* fulfill its fiduciary obligations to review such investments for prudence. While TRA's board *may* possess some knowledge regarding pension investments generally, absent relevant reports and documents, it *cannot possibly* be knowledgeable regarding TRA's specific investments. In reality, TRA's board is exercising *no fiduciary oversight* of the trust's investments whatsoever. Any claims to the contrary are grossly misleading to pension stakeholders.

- **SBI Complete Failure to Respond to Public Records Request**

Given the lack of clarity regarding the governmental entity holding documents related to TRA's investments, on April 15, 2024, a member of the Facebook Group requested from SBI, among other records, the very same documents we had requested from TRA on April 11th. On April 22nd, Jill Schurtz, Executive Director and Chief Investment Officer of SBI responded:

With respect to your document requests in items 5-14, we will respond in accordance with the SBI's data practices procedure. Our team will correspond with you separately regarding that process.

On June 12, 2024, given the substantial passage of time (nearly 2 months) since the Facebook Group public records request, we again requested the very same documents from SBI and requested confirmation of receipt of our request. Once again, on June 18, 2024, we requested confirmation of receipt of our request and on June 20th finally received confirmation from John Mule, General Counsel of SBI.

We note that according to SBI's website, the fund merely states:

"If the data you have requested is **nonpublic**, we will inform you as soon as reasonably possible and identify the law that prevents us from providing the data. If the data requested is **public**, we will respond to your request appropriately and promptly, within a reasonable amount of time…"[14]

We received nothing.

Since early April, we have not been provided with *any* of the data we have requested regarding TRA's basic investment operations from TRA or SBI. We have not been informed that SBI does not possess the data or that any of the data we requested is nonpublic.

The lack of cooperation by TRA and SBI was all-the-more surprising given that both pensions were well-aware that this forensic review was commissioned, as well as paid for, by thousands of participants with the stated objective of improving management and oversight. Pension fiduciaries solely concerned with the best interests of participants and beneficiaries should welcome, not obstruct, a free independent review by nationally recognized experts. Further, given the profound concerns stakeholders have long raised, it is clear both pensions could benefit from an independent review by experts—this time not of their own choosing.

TRA claims it has *no data* to disclose regarding its investments and SBI has chosen to simply *not respond* to repeated requests for such data. Whether SBI even has the data requested is *unknown*.

As a result, it is simply impossible for stakeholders in Minnesota's state pensions (including participants and taxpayers)—no matter how sophisticated or diligent—to determine whether the assets in such funds

[14] https://msbi.us/how-to-request-data

are prudently invested, properly valued, and safely custodied, or even exist. It is impossible for stakeholders to know if the fiduciaries overseeing these retirement funds are in possession of and have reviewed key investment documents consistent with their fiduciary duties.

In summary, despite any state laws mandating transparency:

Public pensions in Minnesota are not subject to public scrutiny.

- **TRA Records Participant Calls Without Consent; TRA and SBI Refuse To Record Board Meetings For Public Scrutiny**

Further, while teachers have long pressed the TRA board to enhance transparency by recording its meetings (so that active teachers and other stakeholders who are unable to attend board meetings held during the workday can be informed as to its dealings), audio recordings of such meetings were supposedly stopped at some point in the past on advice of legal counsel (apparently the Attorney General)—without explanation.[15]

We note public pension board meetings around the country are routinely recorded, both on audio and video and even broadcast live via audio web stream.[16] There is simply no good reason TRA participants or stakeholders should be denied the opportunity to scrutinize the board's actions through recorded meetings. Indeed, recording of the meetings would quickly expose that, as discussed above, the TRA Board neither possesses nor reviews key information regarding the pension's

[15] As recently as April, 2024, the minutes of the TRA board meeting indicate:

Stoffel reported that TRA staff have been discussing recording board meetings and considering the various issues that need to be researched before a decision can be made, such as development of a retention schedule, equipment and logistical components, and possible legal implications the attorney general's office will need to provide guidance on. He noted that the issue was previously discussed by the board. At that time, audio recordings of board meetings were stopped on advice from legal counsel, so that will need to be reviewed.

[16] https://www.psprs.com/about/board-of-trustees-meetings/

investments. (We note that SBI also does not record its Board meetings to enhance transparency.)

While TRA will not permit recording of meetings of its board to enhance public scrutiny, recent data provided by TRA to participants pursuant to individual public record requests reveal the pension routinely records telephone conversations with participants—without notice or consent—and internally disparages participants critical of its operations, unbeknownst to them.[17] Clearly, TRA and SBI opposition to recording their own board meetings—supposedly due to "legal implications"—yet willingness to secretly record and comment upon participants is indicative of a culture of defensiveness and hostility toward stakeholders.

IV. Teachers Retirement Association

- **TRA Financial Statements**

An Annual Comprehensive Financial Report (ACFR) of TRA is prepared by the TRA accounting and executive staff and TRA financial results are incorporated into the ACFR of the State of Minnesota with its fiduciary funds.

Both the Office of the Legislative Auditor and CliftonLarsonAllen LLP are named as auditors in the TRA 2023 ACFR. The Office of the Legislative Auditor, which is referred to by TRA as the "external" or "independent" auditor provides an opinion on TRA's financial statements on an annual basis. The OLA's Report states "We are required to be independent of TRA…" Whether OLA is truly independent of TRA is

[17] In August, a Facebook Group member and participant posted that she had "made a document request to TRA asking them to share any files, phone calls, emails they've kept on me. They sent me 97 documents and 13 recorded phone calls they've been storing on me. They also referred to me in an internal email as a "squeaky wheel."" The phone recordings were also posted in the Facebook Group.

debatable, particularly given that OLA joined with TRA and other state officials to oppose this investigation.

According to its financial statements, TRA "is *an administrator* (emphasis added) of a multiple employer, cost-sharing retirement fund" which provides retirement, disability and survivor benefits to Minnesota's public educators. Teachers employed in Minnesota's public elementary and secondary schools, charter schools, and certain educational institutions maintained by the state are required to be TRA members. State university, community college, and technical college teachers first employed by Minnesota State may elect TRA coverage within one year of eligible employment.

As of June 30, 2023, TRA had 606 reporting units, 84,983 active members and a total of 70,344 retirees, survivors, beneficiaries, and disabilitants who were receiving monthly benefits. Total membership, including terminated members with deferred vested benefits and non-vested members entitled to a refund of contributions, amount to 214,834.

For financial reporting purposes, TRA is considered a *pension trust fund* (emphasis added) of the State of Minnesota. Total plan assets of the TRA fund as of June 30, 2023 were $28.2 billion.

TRA is governed by an eight-member Board of Trustees consisting of five elected representatives, one representative of the Minnesota School Boards Association, the Commissioner of the Department of Education, and the Commissioner of Minnesota Management and Budget. Four of the five elected positions represent active teachers and one is a retired representative position. The Administrative Staff consists of an Executive Director, Deputy Executive Director, Legal and Legislative Director and Chief Financial Officer.

- **TRA Board Fiduciary Duty Extends to Both Administration and Investments**

According to the TRA Handbook of Member Benefits and Services:

"The trustees are knowledgeable in both pension administration and investments under state law. Although the Minnesota State Board of Investment (SBI) manages all TRA pension fund investments, the trustees must exercise their fiduciary decisions in the same careful manner that they would use in making their own retirement decisions. The benefit needs of all pension fund participants must be considered by trustees regardless of any individual constituency that may have been instrumental in their election. The trustees also appoint an executive director who is responsible for the administrative management of the plan."[18]

In its Mission Statement,[19] TRA acknowledges it has a "fiduciary duty to ensure the financial stability of the plan…" and "TRA will continually monitor the plan's financial health."[20] As indicated above, this TRA trustee fiduciary duty includes *both* pension administration and investments.[21]

- **TRA "Endangered" Funding Status**

For the fiscal year ended June 30, 2023, the funded ratio of the pension was 76.9 percent, a decrease from 82 percent a year earlier. This means only 76.9 cents have been set aside for every dollar that actuaries

[18] https://minnesotatra.org/wp-content/uploads/2022/04/Member-Handbook-4-26-2022.pdf, pg. 25.

[19] https://minnesotatra.org/wp-content/uploads/2023/12/FY23-ACFR-Report.pdf

[20] https://minnesotatra.org/wp-content/uploads/2023/12/FY23-ACFR-Report.pdf

[21] According to the Approved Minutes of the August 16, 2023 TRA Board meeting, TRA Board members receive fiduciary training: "Ice Miller presented material on the fiduciary responsibilities and duties of Board members. The presentation included information about who is a fiduciary, what it means to be a fiduciary, the duties of care and loyalty, when fiduciary duties are owed, the purpose of fiduciary duties, conflicts of interest, breach of fiduciary duties and co-fiduciary responsibility, authority delegation, information about the data practices act, and the board communication policy."

calculated the plan should have had on hand to pay for promised benefits.

Federal pension law (Pension Protection Act of 2006)[22] designed to address alarming funding problems encountered by many multiemployer corporate pensions establishes three categories (or zones) of plans: (1) Green Zone for healthy; (2) Yellow Zone for endangered; and (3) Red Zone for critical. These categories are based upon the funding ratio of plan assets to plan liabilities. In general, Green Zone plans have a funding ratio greater than 80 percent, Yellow Zone plans have a funding ratio between 65 percent and 79 percent, and Red Zone plans are less than 65 percent funded. Each plan's actuary must certify the plan status every year and participants and employers must to be notified of the status of the plan. Each Yellow Zone plan must adopt a funding improvement plan designed to increase its funding percentage and Red Zone plans must adopt rehabilitation plans designed to allow the plans to emerge from critical status within 10 years.

Under the federal scheme, at 76.9 percent funded, TRA would be considered in the Yellow Zone for *endangered* and would be required to adopt a funding improvement plan designed to increase its funding percentage.

The investment return assumption used by TRA was reduced effective July 1, 2023 from 7.5 percent to 7 percent, as recommended by the actuary for the plan. Interestingly, in an April 2021 Commentary, the Chief Financial Officer of CalPERS, the nation's largest public fund stated, "… CalPERS can't keep counting on a 7% return target without taking on more risk. Whether we can even achieve 7% return without taking on excessive risk will be the major question in this year's Asset

[22] https://www.govinfo.gov/content/pkg/PLAW-109publ280/pdf/PLAW109publ280.pdf

Liability Management process."[23] CalPERS' assumed investment rate of return was subsequently reduced in July 2021 to 6.8 percent.[24]

According to a March 2024 survey of 131 public funds by the National Association of State Retirement Administrators (NASRA), the average investment return assumption of funds has declined from 7.95 percent in 2007 to 6.91 percent currently. [25] Says NASRA:

> In terms of its effect on a pension plan's finances and funding level, the investment return assumption is the single most consequential of all actuarial assumptions. The sustained period of historically low interest rates, which lasted for over a decade beginning in 2009, combined with lower projected returns for most asset classes, caused many public pension plans to reduce their long-term expected investment returns.

The Pew Charitable Trusts notes that "By 2021, the average state pension plan was assuming that future returns will be around 7 percent." However, "with recent projections showing that future pension plan returns are likely to be closer to 6% than 7% over the next 20 years, below both historical averages and what most state pension plans continue to rely on, policymakers will need to find ways to further reduce investment expectations.[26]

In 2023, the unfunded actuarial liability of the pension was $35 billion, an increase from $31.6 billion a year earlier. If the net pension liability were calculated using a discount rate which is one percentage point lower than the current assumption—i.e., the more realistic 6 percent rate

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[23] https://calmatters.org/economy/2021/04/calpers-review-of-its-investment-strategy-and-actuarial-assumptions/

[24] https://www.calpers.ca.gov/docs/forms-publications/facts-investments.pdf

[25] https://www.nasra.org/files/Issue%20Briefs/NASRAInvReturnAssumptBrief.pdf

[26] https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/11/public-retirement-systems-need-sustainable-policies-to-navigate-volatile-financial-markets

estimated by Pew—the current underfunding would soar to approximately $40 billion.[27]

V. TRA's Complex Structure Amounts to "Sleight of Hand"

- **SBI Manages All TRA Assets**

All TRA assets are invested under the authority of and direction of the SBI, as per Minnesota Statues, section 11A.24.

"The State of Minnesota acts as a fiduciary and trustee of TRA's funds." Thus, the SBI, *as well as the TRA*, has a fiduciary duty to ensure that assets of the plan are prudently invested.[28]

All members of the SBI are elected officials—the Minnesota Governor (who is designated as chair of the Board), State Auditor, Secretary of State and Attorney General. This governance structure is fundamentally flawed in that *none* of these politicians has any pension expertise and *all* may receive campaign contributions directly or indirectly from investment firms holding (or seeking) lucrative contracts to manage the massive state fund's assets. Indeed, the Chairman of the Board, Governor Walz, according to recent financial disclosures has never owned a stock or bond.

- **TRA Abundance of Board Oversight**

The legislature has also established a 17-member Investment Advisory Council (IAC) to advise the SBI and its staff on investment-related matters. All proposed investment policies are reviewed by the IAC before

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[27] https://minnesotatra.org/wp-content/uploads/2023/12/2023-MN-TRA-Valuation-Report.pdf

[28] Notes to TRA's Financial Statements indicate "The Board of Trustees (of the TRA) is responsible for TRA's administration, but the SBI is responsible for investing plan assets," however, this statement appears to conflict with statements in the TRA Handbook of Member Benefits and Services cited earlier regarding TRA Board member investment knowledge and fiduciary oversight.

they are presented to the Board for action. According to its Mission Statement, "The IAC fulfills its statutory duty to the Minnesota State Board of Investment (SBI) by providing advice and independent due diligence review of the investment policy and implementation recommendations that guide the SBI's investment of assets." The SBI "appoints ten members from the public experienced in finance and investment. These members traditionally have come from the Minneapolis and St. Paul investment community." The Commissioner of Minnesota Management and Budget and the Executive Directors of the three statewide retirement systems (Minnesota State Retirement System, Public Employees Retirement Association, and Teachers Retirement Association) are permanent members of the IAC. The Governor appoints two active public employee representatives and one retiree representative to the IAC.

In conclusion, it appears that TRA's assets are overseen by *three* different Boards of trustees including, TRA (8 members), SBI (4 members) and IAC (17 members), *all of which are fiduciaries to the plan.*

The SBI has developed strategic asset allocation and other investment policies for the fund and the SBI, with advice from its Investment Advisory Council (IAC) reviews policies and asset allocation to ensure sufficient assets are available to finance benefits determined under statute.

Remarkably, despite an apparent *abundance of board oversight*, even a cursory review of TRA and SBI reveals glaring, obvious deficiencies and inconsistencies which should have been identified and addressed years ago by one or more of the boards.

- **Lack of Transparency and Other Risks Related to Combined Funds**

The state's public retirement fund assets, including TRA, are invested under the authority and direction of the SBI and are commingled in various pooled investment accounts, commonly referred to as the Combined Funds. TRA *does not own* any underlying assets, but instead owns a participation in the pooled Combined Funds. That is, each participating retirement fund owns an undivided participation in the Combined Funds' pooled investment accounts.

The Combined Funds structure creates unnecessary complexity, heightened risks and a profound lack of transparency. Prudent practice dictates that pension assets be managed by the plan sponsor, separately custodied and held in the name of the plan. Plan investment holdings should be clearly identified/disclosed to participants so that participants can judge for themselves whether the assets are suitable and properly managed.

Having TRA's assets custodied elsewhere, held in another plan's name, in opaque funds under the authority and direction of others amounts to a "sleight of hand." No reasonable participant would accept the additional risks to their retirement security the Combined Funds structure creates—assuming any participant could even understand the risks related to the Combined Funds.

Worse still, there are *no benefits* from the Combined Funds structure. While SBI claims that by pooling the assets, it can offer institutional investment management at a low cost, the available evidence indicates that the fund has increasingly embraced high-cost investment vehicles that fail to perform competitively. Potential economies of scale are not realized, as a result of mismanagement by SBI. As discussed further elsewhere, the structure has historically merely served to obscure, or conceal investment underperformance and underreporting of investment fees and expenses.

The long-term objectives of the Combined Funds are:

1. Provide returns that are 3-5 percentage points greater than inflation over the latest 20-year period; and
2. Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over the latest 10-year period.

For 2023, the SBI followed its strategic asset allocation policy for the combined retirement funds. The policy combines domestic and international equities into the public equity category with a target of 50%. There is a 25% target allocation in private markets that includes private equity, private credit, real estate and resources. If the private markets are invested at less than the 25% target, the difference is invested in public equity using a strategy comprised of physical securities in combination with an overlay program fully collateralized by cash. Fixed income, a laddered bond and cash portfolio, and treasuries have a total target allocation of 25%.

VI. SBI Investment Beliefs

SBI has adopted a set of Investment Beliefs for managing the assets of the Combined Funds it manages to support the defined benefit plans of the state's employees.

The primary purpose of these Beliefs is to guide the SBI toward sound investing principles related to investing on behalf of the Combined Funds. In this respect, the Beliefs help provide context for SBI's actions, reflect SBI's investment values, and acknowledge SBI's role in supporting the State's retirement systems. When relevant, the SBI also uses these Beliefs as a guide when investing the assets of the other investment programs it manages, as deemed appropriate.[29]

[29] MSBI 2023 Annual Report, page 7.

- **No Commitment to Transparency or Low-Cost Investing**

Notably, the Investment Beliefs neither include any commitment to transparency nor low-cost investing. As discussed throughout this report, there is ample evidence indicating greater transparency leads to better outcomes, while greater secrecy inevitably leads to fraud, mismanagement and waste.

Keeping investment costs low is a vital investment principle since investment expenses come directly from returns. Further, expenses are the *only* aspect of investing a pension can control. While the Investment Beliefs include the seemingly obvious statement, “There are long-term benefits to SBI managing investment costs,” this is not the same as indicating a clear preference for lower-cost investments. As discussed extensively later, the SBI and TRA report investment returns net of fees only—without disclosing gross returns, which serves to conceal cost. Further, SBI’s financial statements prominently disclose that pension trustees *focus exclusively* upon net returns, i.e., do not monitor costs consistent with their fiduciary duties.

- **Commitment to Passive Management**

The Beliefs include the admission:

> It is extremely challenging for a large institutional investor to add value over market-representative benchmarks, particularly in the highly competitive public global equity markets. Passive management should be utilized when there is low confidence that active management can add value. Active management can have potential to add value where information processing is difficult and challenging, allowing for market inefficiencies that are potentially exploitable.

This Belief should reinforce the importance of limiting costs in selecting among investments. Nevertheless, SBI’s Combined Fund Domestic includes 13 active equity managers—along with passive managers—with long term net returns that have not exceeded the benchmark. SBI’s stated Belief, as well as long-term investment experience, should have long ago dictated termination of the active domestic equity pool managers, with resulting savings in investment fees and expenses.

- **Private Equity Illiquidity Premium**

The following Belief is questionable, as well as inconsistent with SBI practices.

Private market investments have an illiquidity premium that the SBI can capture. The risk premium can increase the portfolio's long-term compound return and help diversify the portfolio's risk.

If true, then SBI's benchmark for private markets investments should include an illiquidity premium—which it does not.[30] As discussed elsewhere, we recommend a 500-basis point illiquidity premium which—if applied--would expose historic underperformance. Further, since private investments have exponentially greater costs and are almost universally less transparent, this Belief embraces rather than eschews high-cost alternatives and opacity.

- **ESG Policy**

Finally, the Beliefs state:

Utilizing engagement initiatives to address environmental, social and governance-related issues can lead to positive portfolio and governance outcomes. In addition to specific engagement strategies the SBI might apply, proxy rights attached to shareholder interests in public companies are also "plan assets" of the SBI and represent a key mechanism for expressing SBI's positions related to specific ESG issues. By taking a leadership role in promoting responsible corporate governance through the proxy voting process, SBI can contribute significantly to implementing ESG best practices which should, in turn, add long-term value to SBI's investments.

[30] SBI reviews the performance of its private markets investments, relative to inflation, as measured by changes in the Consumer Price Index. Comparing private markets performance to the CPI's 2.5% annualized performance over the past 30 years is not only **absurdly inappropriate** (given the massive costs and risks related to private markets investments), but **virtually ensures** that private markets (and the SBI as a whole) will handily outperform its Composite Benchmark annually and overtime.

In recent years state pensions have increasingly created rules and mandates targeting ESG investment strategies. Nevertheless, ESG investing today is more controversial than ever. In 2024 alone, more than two dozen ESG bills have been introduced—some favorable to ESG but most oppositional—and six so far are now law.

ESG investment strategies have traditionally focused on the long-term impacts of investing in industries that could be economically, environmentally, or politically undesirable. From an investment perspective, the goal has been to limit exposure to potential risks. Some state policymaker efforts around ESG have conflated this traditional use with what is known as impact investing, a strategy that aims to achieve certain social or environmental outcomes.

According to Pew, 2024 has seen an evolution toward a more measured approach—on both sides of the issue—with a greater recognition that strict pro- and anti-ESG investing mandates can lead to unintended costs and administrative challenges.

Public pensions, notes Pew, tend to use ESG factors to illuminate material risks and opportunities—such as a company's record on employee relations or compliance with environmental regulations—that should be considered as part of any financial decision-making process. That is, pensions use ESG to inform overall investment and risk management strategies. State policymakers, however, have largely viewed ESG through a "social impact" lens, which has prompted policies either prohibiting or requiring certain ESG-related investments. Not only is this view potentially out of alignment with pension systems' fiduciary role to act in the best interest of its beneficiaries, it also risks leaving money on the table, says Pew.

Pew concludes:

> Lawmakers' and financial practitioners' differing interpretations of ESG can lead to confusion and politicization. Recent laws governing ESG investing, whether with a

favorable or unfavorable view, may intend to mitigate exposure to financial risks for pension funds and other critical state investments, but in practice, some laws are having the opposite effect. These conflicting outcomes make it even more challenging to implement ESG mandates, as evidenced by a recent ruling in Oklahoma that halted the state's energy law. In her ruling, Judge Sheila Stinson wrote that it was very likely the law's "stated purpose of countering a 'political agenda' is contrary to the retirement system's constitutionally stated purpose" to act in the best interests of its beneficiaries.

These latest developments underscore the fact that policies restricting investment options often force officials to make immediate and unanticipated changes to investment and borrowing strategies and approaches. The resulting upfront transaction costs and administrative challenges could ultimately mean greater costs to taxpayers to meet states' retirement obligations…[31]

As noted on the SBI website,[32] at its February 2020 meeting, the SBI passed a resolution concerning ESG initiatives. Consistent with its fiduciary responsibility, the Board determined the following measures be taken:

- Continue to actively vote proxies in accordance with SBI proxy guidelines, policies, and precedents as approved by the Board.
- Continue to participate in ESG coalitions and engage with corporations on ESG related issues.
- Prepare and update a Stewardship Report and other ESG informational materials.
- Develop and implement plans for reporting and addressing ESG investment risks; to evaluate options for reducing long-term carbon exposure; and to promote efforts for greater diversity and inclusion on corporate boards and within the investment industry.

[31] https://www.pewtrusts.org/en/research-and-analysis/articles/2024/06/27/a-more-measured-approach-as-states-navigate-environmental-social-and-governance-mandates

[32] https://msbi.us/ESG-stewardship

Further, the SBI participates in multiple organizations that address ESG issues including the Council of Institutional Investors and the United Nations Principles of Responsible Investment. Says SBI:

These organizations provide research, engagement opportunities and other resources that enable the SBI to more effectively assess relevant ESG issues. Common issues include, but are not limited to, climate; gender, racial, and ethnic diversity; shareholder rights; corporate governance; and workers' rights. The SBI continues to assess additional resources.

With respect to Manager Due Diligence, SBI states:

SBI investment staff work with external investment managers to address ESG-related risks within the manager's investment portfolios and within the managers' organizations themselves. Most managers have a documented ESG integration approach and DEI policy. In general, the goal is to assess the quality of these approaches. The team tries to establish consistency in information gathering that will help evaluate managers over the long-term and track changes as they are revealed in subsequent meetings. It is important for managers to both evaluate ESG risks and opportunities prior to making an investment; and add value by improving ESG practices once a company is purchased.

As many commentators have observed, for all the debate surrounding the use of ESG for investing, the "G" or governance is often overlooked.[33]

In the intricate web of sustainability, where environmental concerns and social impact often claim the spotlight, one critical pillar remains steadfast in its significance: governance, the unsung hero shaping the very foundation of ESG.

Governance is the system of rules, policies and practices by which a company is managed in a responsible, ethical and transparent manner. It involves the relationship between a company's management and its board of directors, its investors and other stakeholders, to whom it is accountable.

It therefore forms the bedrock of the ESG agenda, as it encompasses not only one-third of the ESG equation but also acts as a prerequisite for achieving all ESG goals. Behind every violation of environmental or social commitments lies a failure in corporate governance, whether it's insufficient anti-corruption measures, flawed

[33] https://hbr.org/2022/11/its-time-to-focus-on-the-g-in-esg

incentive systems, conflicting lobbying efforts, ineffective board supervision or unprepared leadership.

In essence, sustainable governance lies at the core of the ESG agenda, and overlooking it can hinder a business's sustainability progress.[34]

The SBI (and TRA) ESG Policies are deeply flawed in that they focus upon *external* popular environment and social issues but fail to address the funds' greatest *internal* governance issues: a profound lack of transparency, failure of board oversight and grossly misleading performance and fee disclosures to the public.

It is ironic that seemingly the only "ills" these two pensions are unwilling to address are those *within their own halls*.

Indeed, if the funds were committed to operating in a "responsible, ethical and transparent manner" and improving "the relationship between… management and its board of directors, its investors and other stakeholders, to whom it is accountable," they would never have preemptively, aggressively sought to undermine a participant-funded investigation by an independent expert into potential mismanagement and wrongdoing.

Most disturbing, improving transparency, board oversight and reporting to the public would have an enormous impact upon the performance of the pensions, potentially improving retirement security for participants and lowering taxpayer costs—objectives clearly consistent with the fiduciary duties of the funds' boards.

Further, there are *no costs* related to improving governance of the pensions, indeed, better governance through transparency will actually *lower costs*. For example, if SBI and TRA required their external investment managers to be fully transparent regarding conflicts of

[34] https://sustainabilitymag.com/articles/governance-the-overlooked-foundation-of-esg-success

interest and fees, fee competition would be enhanced and any excessive, bogus or illegal fees would be eliminated.

Requiring external investment managers to be compliant with environment and social concerns while they operate in secrecy, i.e., ignoring transparency governance, is absurd.

Although governance risks pose challenges, it is a crucial part of ESG. Effective governance ensures compliance, transparency, and accountability while addressing environmental and social risks. It integrates ESG considerations into decision-making, drives sustainable practices and attracts responsible investment. Strong governance builds trust, enhances stakeholder confidence and enables organizations to navigate complex ESG landscapes for long-term value creation and positive societal impact.[35]

In conclusion, improving *governance* at SBI and TRA—consistent with the funds' ESG Policy—should include, but not be limited to, the following:

1. Enhanced transparency through rigorous enforcement of public records laws, including but not limited to, disclosure of all investment documents to the public and any of the three oversight boards;
2. Recording of all board meetings so that active, as well as retired teachers and other stakeholders can access the meetings;
3. Independent investigation into the accuracy of investment performance and investment costs reporting of the funds over the past 30 years.
4. The CIO and/or consultant, who are responsible for designing and implementing the investment program, should not be involved in benchmarking and reporting of investment performance.

[35] https://sustainabilitymag.com/articles/governance-the-overlooked-foundation-of-esg-success

VII. Fiduciary Duty to Ensure Investment Fees and Expenses Are Reasonable

Unlike most other industries, the fees money managers charge institutional and retail investors for *comparable* investment services *vary astronomically*.

Passive, or index investment management services, can be purchased by institutional investors for 1 basis point (one one-hundredth of a percent) or even "for free."[36]

Passive investment management refers to a strategy in which an investor seeks to track a specific market index or benchmark, rather than actively selecting individual investments in an attempt to outperform the market. This approach typically involves investing in a diversified portfolio of securities that mirror the composition of the chosen index, such as the S&P 500 or the Dow Jones Industrial Average.

Passive investment management is characterized by a buy-and-hold strategy, with minimal trading or adjustments made to the portfolio over time. The goal is to achieve returns that closely align with the performance of the overall market, while minimizing costs and reducing the risks associated with trying to beat the market through active management.

One of the key advantages of passive investment management is its simplicity and low cost compared to actively managed funds, as there is less need for expensive research, analysis, and frequent trading. Additionally, passive investing can provide investors with broad market exposure and diversification, which can help to reduce portfolio volatility and minimize the impact of individual stock or sector fluctuations.

[36] Certain index managers will manage large accounts at no cost, in exchange for securities lending income related to the portfolio.

Active managers, who attempt to beat the market by stock-picking, may charge pensions fees that are 100 times greater (1 percent). Alternative investment managers, including hedge, venture and private equity, may charge asset-based, performance and other fees amounting to approximately 8 percent—800 times greater fees than indexing.

Paying higher fees for active traditional or alternative asset management does not guarantee and, in fact, *negatively correlates* to superior net investment performance. Indeed, the overwhelming majority of active managers fail to outperformance market indexes over time net of fees. The higher the fees, the greater the drag on investment returns.

A 2013 report by the Maryland Public Policy Institute and the Maryland Tax Education Foundation which examined the investment fees and investment performance of state pension funds concluded:

"State pension funds, including Maryland, have succumbed for years to a popular Wall Street sales pitch: "active money management beats the market." As a result, almost all state pension funds use outside managers to select, buy and sell investments for the pension funds for a fee. The actual result — a typical Wall Street manager underperforms relative to passive indexing — is costly to both taxpayers and public sector employees.

For example, **the top ten states — in terms of Wall Street fees — had a lower pension fund investment performance — over the last five fiscal years — than the bottom ten states** (emphasis added) ... State pension funds should consider indexing. Indexing fees cost a state pension fund about 3 basis points yearly on invested capital vs. 39 basis points for active management fees (or 92 percent less) … By indexing most of their portfolios, we conclude the 46 state funds surveyed could save $6 billion in fees annually, while obtaining similar (or better) returns to those of active managers."[37]

It is well established that sponsors of private retirement plans protected by the comprehensive federal law, Employee Retirement Income Security Act of 1974 (ERISA), have a fiduciary duty to ensure that the

[37] Wall Street Fees, Investment Returns, Maryland and 49 Other State Pension Funds by Jeff Hooke and John J. Walters, July 2, 2013.

fees their plans pay money managers for investment advisory services are reasonable. Fees paid for such retirement plan investment services have always been an important consideration for ERISA fiduciaries; however, in recent years such fees have come under increased scrutiny because of class action litigation, Department of Labor regulations, and congressional hearings.

According to the Department of Labor:

> "Plan fees and expenses are important considerations for all types of retirement plans. As a plan fiduciary, you have an obligation under ERISA to prudently select and monitor plan investments, investment options made available to the plan's participants and beneficiaries, and the persons providing services to your plan. Understanding and evaluating plan fees and expenses associated with plan investments, investment options, and services are an important part of a fiduciary's responsibility. This responsibility is ongoing. After careful evaluation during the initial selection, you will want to monitor plan fees and expenses to determine whether they continue to be reasonable in light of the services provided."

State and local government pensions are *exempt* from ERISA and are governed by state law. However, because ERISA and state law protections both stem from common law fiduciary and trust principles, best practices for public pensions are frequently similar to those found in ERISA.

At the outset, sponsors of public, as well as private retirement plans must take steps to understand the sources, amounts, and nature of the fees paid by the plan, as well as the related services performed for such fees. After all, a plan sponsor cannot determine the reasonableness of fees without a comprehensive understanding of the services received in exchange for fees paid.

Whether a plan's fees are reasonable depends upon the facts and circumstances relevant to that plan. The plan sponsor must obtain and consider the relevant information and then make a determination supported by that information.

- **Opaque "Alternative" Investment Fees and Expenses**

In the past two decades, public pensions, including TRA and SBI, have allocated ever-greater assets to more complex, opaque so-called "alternative" investment vehicles, such as hedge, private equity and venture funds, as well as fund of funds. Overall, state and local plans have reportedly increased their holdings from 9 percent in 2001 to 34 percent in 2022.[38] (Based upon our forensic investigations, we believe the actual percentages are far higher.) This shift has brought dramatically higher investment fees—fees which are often not fully disclosed and may be much more difficult for pensions to monitor.

According to a 2023 study by Pew:

"Public pension plans' use of alternative investments has more than doubled over the past 15 years. And with that, total investment fees also have increased, with state funds reporting costs in excess of $10 billion annually. From 2006 to 2019, fees as a share of total investments grew from 0.26% to 0.35%—a 30% increase as a percentage of assets.[39]

In addition, public funds are paying more than $4 billion annually in *unreported* fees associated with alternative investments, according to Pew. The hidden costs of private equity investments – which include carried interest, monitoring costs, and portfolio company fees – were not reported as investment expenses among most of the 73 large public funds Pew examined, according to a 2017 report from the non-profit group.[40]

According to Pew:

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[38] https://crr.bc.edu/wp-content/uploads/2022/11/IB_22-20.pdf

[39] https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/10/transparency-in-investment-disclosures-helps-promote-effective-public-pension-administration

[40] https://www.institutionalinvestor.com/article/2bsvw78twewe3ztxmu58g/portfolio/the-bill-for-hidden-private-equity-fees-4-billion

"Accounting and disclosure practices also vary widely among pension plans and have not kept pace with increasingly complex investments and fee structures, underscoring the need for additional public information on plan performance and attention to the effects of investment fees on plan health. Full and accurate reporting of asset allocation, performance, and fee details is essential to determining public pension plans' ability to pay promised retirement benefits. With more than $3.6 trillion in assets—and the retirement security of 19 million current and former state and local employees at stake—sound and transparent investment strategies are critical."[41]

While Pew found that since 2016, plans have made progress on transparent fee disclosure, many state plans still do not provide the information stakeholders need to accurately assess investment performance. Whether a plan includes or omits *performance fees* when calculating investment management costs is a significant variable. The average value of undisclosed private equity fees, including carried interest, can equal 1.5% or more of annual assets, or about half of pension funds' total private equity management costs.[42]

- **Reporting Net Investment Results Only Conceals Skyrocketing Costs**

With respect to Minnesota specifically, Pew noted that the state public pension plans report total returns *net of fees only*. Said Pew:

"Reporting investment returns in both gross- and net-of-fee terms gives stakeholders information on the cost and bottom-line results of pension funds' investment strategies. Directly comparing net and gross returns is a clear, easy way to view the impact of fees on fund performance."

However, neither TRA nor SBI report investment returns both gross- and net-of-fees.

[41] https://www.pewtrusts.org/~/media/assets/2017/04/psrs_state_public_pension_funds_increase_use_of_complex_investments.pdf

[42] https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/10/transparency-in-investment-disclosures-helps-promote-effective-public-pension-administration

Equally disturbing, SBI's Annual Reports include the following unusual, prominent warning or "Important Note" prior to the Introduction:

Readers should note that the SBI's returns in this report are shown ***after*** transaction costs and fees are deducted. Performance is computed and reported after all applicable charges *to assure that the Board's focus is on true net returns* (emphasis added).

This statement is profoundly troubling because it indicates SBI has chosen to withhold important information from the public *and its Board* because the pension mistakenly believes investment fees and expenses are not important**,** i.e., are a mere distraction. As a result of its "focus," apparently the Board is *unaware* of the total amounts paid. Evidently the Board as well as the pension's numerous investment advisers, auditors and legal counsel apparently all acknowledge withholding fee information—while, in their opinion, somehow advisable or defensible—is so exceptional that it must be prominently disclosed at the outset of the financials.

We are confident, based upon our experience, that *even SBI staff* does not know the full extent of the fees and expenses the pension pays.

TRA's financial statements, which include the same net of fees returns, do not include the prominent warning or "Important Notes" prior to the Introduction.[43] As discussed further elsewhere regarding performance reporting, this is another example of a troubling feature of TRA's "sleight of hand" structure: Much of the critical information regarding the pension (which is included or featured in SBI's financial statements) is not included or featured in TRA's. As a result, TRA participants have less direct access to important information regarding their retirement savings than SBI participants.

[43] TRA's financial statements indicate the investment returns are presented net of fees only, however, this significant shortcoming is not stated prominently, as with SBI.

In our opinion, an investigation should be undertaken into why the TRA and SBI have chosen to not report investment returns on a gross, as well as net of fee basis, i.e. to *intentionally* withhold critical fee information from stakeholders. Further, why have the TRA and SBI Boards, the IAC, fund auditors (including the Office of the Legislative Auditor) and the various investment consultants apparently failed to address this important issue? In our opinion, the only reason to report total returns on a net of fees basis only is to conceal the total fee amounts—fees which have skyrocketed in recent years.

- **Bogus and Inflated Alternative Investment Fees and Expenses**

A recent internal review by the United States Securities and Exchange Commission found that a majority of certain alternative investment managers, i.e., private-equity firms, inflate fees and expenses charged to companies in which they hold stakes, raising the prospect of a wave of sanctions against managers (including potentially some of the dozens of private equity managers TRA invests in), by the agency, said Bloomberg.[44]

More than half of about 400 private-equity firms SEC staff examined charged unjustified fees and expenses without notifying investors.

Not long after the SEC's revelations, the largest US public pension plan made a stunning acknowledgement of lax oversight. The California Public Employees' Retirement System (CalPERS) acknowledged that it could not say how much carried interest it had paid out over the years to private equity firms because it did not track the amount. To fill the data gap, CalPERS sent out inquiries to some of its fund managers, and the pension plan came up with a figure of $3.4 billion paid out in carried interest from 1990 to 30 June 2015. Those events helped to shape public perceptions of problematic practices in private markets.

"The private-equity model lends itself to potential abuse because it's so opaque, according to Daniel Greenwood, a law professor at Hofstra University in New York and author of a 2008 paper entitled "Looting: The Puzzle of Private Equity." The attraction of the funds is that the

[44] Bogus Private-Equity Fees Said Found at 200 Firms by SEC, Bloomberg News, April 7, 2014.

managers have broad discretion, which also means that investors have a hard time knowing what the managers are doing, he said."

According to another expert cited in the Bloomberg article, "The industry is going to be forced into change because, frankly, when your big investors are public plans and other money that's run by *fiduciaries* (emphasis added), you can't afford as a business matter to be deemed to be engaging in fraud. Fraud doesn't sell very well."

Increased use of alternative investments has bolstered calls for more effective risk disclosures, according to Pew:

Pension plans' growing use of alternative investments in recent years and the lack of standardized disclosure practices have spurred a variety of interventions by regulatory and nongovernmental entities to promote greater consistency in reporting:

- GASB in 2020 launched a research project to evaluate whether existing guidance on disclosing investment fees charged by private investment managers is sufficient.
- More than 180 asset managers and other investment organizations, including some U.S. public pension funds, have endorsed a set of comprehensive fee disclosure practices that the Institutional Limited Partners Association (ILPA), a member organization for private equity managers, introduced in 2016.
- Two private companies serving institutional investors launched the Global Pension Transparency Benchmark (GPTB) in 2021 to provide pension fund managers around the world with a holistic approach to assessing transparency and improving plan outcomes. GPTB evaluated the top five funds in each of 15 countries—75 funds in total—and found a need for substantial improvement in transparency worldwide. The study ranked U.S. public pension funds ninth out of the 15 countries, noting that U.S. funds "did not provide much relevant cost information."

Accordingly, pensions, such as TRA and SBI, which choose to gamble in asset classes—such as private equity funds, specifically cited by regulators for charging bogus fees in violation of the federal securities laws—must establish heightened safeguards to ensure that all fees paid to such managers are properly reviewed and determined to be legitimate, as well as fully disclosed to participants.

- **TRA Limited Disclosed Total Investment Management Fees**

The following are the Total Investment Management Fees[45] annually disclosed in TRA's financial statements over the past 11 years:

Year	Disclosed Fees
2023	$24,190,000
2022	$27,099,000
2021	$25,052,000
2020	$19,160,000
2019	$20,197,000
2018	$21,923,000
2017	$20,594,000
2016	$24,326,000
2015	$27,010,000
2014	$28,205,000
2013	$24,701,000
Total	**$262,457,000**

Each year for the past 11 years, TRA's financial statements indicate a remarkably low and consistent amount—approximately $24 million, or less than 10 basis points of total plan assets. More implausible, as the pension has invested a greater percentage (from 14.5% in 2013 to over 25% in 2023) of its growing total plan assets (from $18 billion in 2013 to

[45] "Investment expenses include administrative expenses of the SBI to manage the state's comprehensive investment portfolio and investment management fees paid to the external money managers and the state's master custodian for pension fund assets." https://minnesotatra.org/wp-content/uploads/2023/12/FY23-ACFR-Report.pdf, pg. 30.

$27 billion in 2023) to high-cost alternative investments—an increase from $2.7 billion to $6.6 billion—disclosed fees have *fallen* and only fluctuated slightly from year-to-year. This is unbelievable since the fees and expenses related to private assets are well-known to be exponentially greater than those related to traditional assets. (Private funds annually charge substantial asset- based fees of approximately 2%, as well as performance fees of 20% or more.)

We note that a comprehensive study of 54 public pensions from 2008 to 2023 conducted by investment expert Richard Ennis shows fees average 1 percent of assets under management. By that metric TRA with $28 billion in assets would be expected to pay over a quarter billion dollars a year to fund managers.[46]

- **TRA Billions Undisclosed Private Investment Management Fees Alone**

In our opinion, it is apparent that Total Investment Management Fees and expenses are grossly underreported annually by both TRA and SBI. The overwhelming majority of Total Investment Management Fees are *not disclosed* to stakeholders.

It appears that only a small percentage—**less than 10%**—of the total fees have been disclosed to the public.

For example, in 2023, the Combined Funds invested approximately 25%, or $6.675 billion of TRA's investment portfolio in private investments. Yet, for the year, TRA reported Total Investment Management Fees of only $24 million. How great were TRA's estimated private equity fees **alone** in 2023?

In 2015, investment cost measurement firm, CEM Benchmarking, concluded that the difference between what pensions *reported* as

[46] https://www.toledoblade.com/opinion/editorials/2024/07/18/editorial-strs-minnesota-meddling-teachers-retirement-association/stories/20240716002

expenses and what they *actually charged* investors averaged at least **2 percentage points** a year. And this estimate, CEM acknowledged, was probably low.[47] CEM has stated private equity fund of funds costs average over **5 percent**. Professor Ludovic Phalippou, at the Said School of Business at Oxford, found that the average private equity buyout fund charged more than **7 percent** in fees each year.[48]

More recently, in 2020, CEM concluded that pensions are reporting, at best, only half of their investment management costs.[49]

"Our research indicates that, at best, only half of true total investment management costs are included in asset owner financial statements. Across the industry this means an enormous amount of costs actually incurred go unreported. Tens of billions of dollars are not reported by asset owners." "We believe our estimate that 49 per cent of costs go unreported in financial statements of annual reports is conservative and the extent of under-reporting is likely to be higher across the entire industry."

Our forensic investigations routinely uncover total fees related to alternative funds and fund of funds in the **7-10 percent** range.[50] Our 2014 forensic investigation of the $87 billion State Employees' Retirement System of the State of North Carolina revealed that the pension paid undisclosed fees approximately of $500 million, in addition to the $500 million in fees it disclosed.[51] Our 2021 forensic investigation of the $90 billion State Teachers Retirement System of Ohio concluded there was ample reason to believe the total fees were nearly double what the pension was reporting, amounting to almost $1 billion annually.[52]

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[47] 1 https://www.cembenchmarking.com/Files/Documents/CEM_article_-_The_time_has_come_for_standardized_total_cost_disclosure_for_private_equity.pdf

[48] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=999910

[49] https://www.top1000funds.com/2020/11/asset-owners-report-half-of-all-costs/

[50] https://www.forbes.com/sites/edwardsiedle/2012/06/26/jp-morgan-hedge-fund-of-funds-out-of-this-world-fees-and-egregious-conflicts/?sh=562ee3342e50

[51] https://www.seanc.org/assets/SEANC_Pension_Investigation_Highlights__Recommen

[52] https://www.orta.org/forensic-audit

Thus, assuming *private investment* all-in fees range from 5% to 7%, Total Investment Management Fees related to TRA's private equity funds **alone** in 2023 range from an estimated **$334 million to $467 million**.

The *undisclosed* private investment fees in 2023 alone—in a single year— substantially exceed *all fees disclosed by the Fund since 2013* ($262 million).

Total undisclosed private investment fees alone since 2013 amount to an estimated nearly **$3 billion.**

Year	Private Assets	5%	7%
2023:	$6.6 billion	$334 million	$467 million
2022:	$6.4 billion	$320 million	$448 million
2021:	$5.6 billion	$284 million	$397 million
2020:	$3.5 billion	$177 million	$245 million
2019:	$3.3 billion	$166 million	$231 million
2018:	$3.1 billion	$156 million	$218 million
2017:	$2.7 billion	$138 million	$193 million
2016:	$2.5 billion	$126 million	$175 million
2015:	$2.4 billion	$122 million	$168 million
2014:	$2.6 billion	$131 million	$182 million
2013:	$2.7 billion	$135 million	$189 million
Total Undisclosed fees		**$2.1 billion**	**$2.9 billion**

- **SBI Tens of Billions Undisclosed Private Investment Management Fees Alone**

In a recent *Editorial: Walz should explain*, the Toledo Blade recently noted that that, like TRA, the SBI discloses only a small amount ($83 million) of the total fees it actually pays Wall Street ($1.3 billion)—i.e., assuming the pension pays overall fees of only 1% annually.

Investment management expenses of $83,208,488 shown by the total Minnesota fund of $134.7 billion are even more suspicious. The Minnesota State Board of Investment claims investment management fees of just over 6/100s of 1 percent on a fund they say is mostly managed by external experts.

If Governor Walz presided over a deal with Wall Street that is 94 percent better than the multi-state average of 54 big pensions measured over 15 years, he should be bragging about that achievement at every presidential campaign stop.

If, however, those numbers don't stand up to close scrutiny, Governor Walz should explain why not and reveal what the Minnesota State Board of Investment actually pays Wall Street.

There is a $1.2 billion difference between what would be the expected fee to Wall Street fund managers and Minnesota's reported payment. That's way too much money to ignore and should be a campaign issue whether it helps or hurts the Harris-Walz ticket.[53]

Assuming SBI's private investment all-in fees range from 5% to 7%, fees related to its private equity funds **alone** range from an estimated **$1.7** billion to **$2.4 billion** annually.

Over the past decade-plus, we estimate **tens of billions** in *undisclosed* private investment fees have been paid by TRA and SBI to Wall Street.

However, there is no need to estimate or debate TRA or SBI's true all-in investment costs since with transparency, the true costs can be

[53] https://www.toledoblade.com/opinion/editorials/2024/08/11/editorial-walz-should-explain-minnesota-teachers-pension-governor-wall-street/stories/20240812003

determined and publicly disclosed, consistent with applicable fiduciary duties—restoring much-needed financial integrity to the pension.

It is well established that cost disclosure and transparency can lead to better decisions. Says CEM: “Clearly there currently are challenges with collecting full private equity costs, but the exercise can yield benefits beyond improved disclosure and transparency. Understanding true costs can lead to lower costs through negotiation with managers. Additionally, understanding costs may lead to more efficient investment vehicle selection because high costs will materially impact private equity performance.”

In conclusion, there is never any justification for a pension to fail to require its managers provide full disclosure of all fees and expenses, or fail to disclose all such costs to pension stakeholders since failure to understand true costs may lead to less efficient investment vehicle selection and negatively impact performance.

In our opinion, it is inconceivable, given public attention regarding the inadequacy of public pension investment fee disclosures and the numerous costly experts TRA and SBI have retained to advise them, the pensions are unaware of the massive fees they have failed to disclose in the past—even if they are clueless as to the exact amounts.

An exhaustive investigation into all TRA and SBI past payments to investment managers should be immediately undertaken, as well as recovery pursued with respect to any illegitimate or excessive payments, in our opinion. Given widespread industry abuses (as documented by SEC staff), and TRA and SBI’s failure to diligently monitor all investment fees and expenses, the likelihood of bogus charges is high, in our opinion. Finally, disclosure of historic costs should be adjusted to correct any past underreporting or errors.

VIII. $360 Million Annual Fees To Wall Street for Doing Nothing

Among the many controversial practices related to private equity and debt investing are the (1) charging of investment management fees on 100 percent of "committed capital," but (2) only reporting performance on invested or "called capital." These are matters about which legendary investors Warren Buffett and Charle Munger have repeatedly criticized the industry, including during Berkshire Hathaway Annual Meetings and Reports.[54]

With respect to charging fees on committed capital, after the investor makes a capital commitment to a private fund, management fees are charged on the entire commitment amount, regardless of whether the capital is actually drawn or invested. *Paying fees on committed, uninvested capital results in exponentially greater fees on assets under management on a percentage basis.* For example, imagine TRA contractually agrees (commits) to invest $100 million (capital) in a private fund over the next ten years, but only actually deposits $10 million into the fund early on. If the fee is 2 percent annually on committed capital (including the uninvested amount of $90 million), TRA will be charged fees of 2 percent annually on $100 million or $2 million, not 2 percent of $10 million or $200,000—even though the adviser is only actually managing (investing) $10 million of the pension's assets initially. Note that in the example, 2 percent on "committed, uninvested capital" equates to an astronomical fee of 20 percent of the $10 million actually invested initially.

Fees on committed, uninvested capital amount to paying managers for **doing nothing**—no service whatsoever is provided in exchange for the lavish fee. In our opinion, such fees add insult to injury since these types of investment funds already charge exponentially higher fees than

[54] https://finance.yahoo.com/news/warren-buffett-condemns-pe-industry-050000021.html?fr=sycsrp_catchall

traditional stock and bond managers.[55] For example, the bulk of private capital funds—82 percent—charge performance fees (aka "carried interest") of 20 percent, in addition to asset-based fees of 2 percent, as well additional operational and organizational fees.

In 2017, reportedly 91 percent of private equity buyout funds and 50 percent of private credit managers demanded investors pay fees today on money investors had committed to invest over time, say, over the next 10 years.[56] According to a more recent 2023 Private Credit Fees and Terms Study,[57] only a small portion of management fees (5 percent) are paid on committed capital, generally for newer funds. However, 59 percent of private capital management fees are paid on half committed/half invested capital. In other words, 64 percent of private credit fees include fees on committed capital.

Not surprising, unlike TRA and SBI, savvy institutional investors are increasingly resisting paying rich fees to private managers based upon their capital commitments and opting for alternatives that do not charge such fees.

According to Figure 8 in the TRA Financial Statements as of June 30, 2023, the pension had unfunded commitments related to investments measured at net asset value in the following amounts (in thousands):

Private Equity: $2,494,894

Real Estate: $536,572

Real Assets: $182,900

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[55] https://www.forbes.com/sites/edwardsiedle/2019/05/01/when-money-managers-get-paid-handsomely-for-doing-nothing/?sh=2831ea385866

[56] https://www.pionline.com/article/20170725/INTERACTIVE/170729897/fees-on-committed-capital-the-norm-in-private-equity-funds

[57] Callan Institute 2023 Private Credit Fees and Terms Study.

Private Credit: $407,365

Total: $3,621,731

According to the Financial Statements, "TRA has a total of $3.6 billion in unfunded commitments to the investments valued at NAV. Unfunded commitments is money that has been committed to an investment but not yet transferred to the General Partner (Investor)." Whether TRA has any unfunded commitments to any other investments, not included in the above figures, is unknown at this time.

Fees on committed capital generally range from 1.56 percent to 2 percent. Assuming TRA pays fees of 2 percent on total unfunded commitments, this amounts to an estimated annual waste of approximately **$72 million**.

As discussed extensively earlier, it is unclear whether TRA monitors or knows the full fees—including fees on committed, uninvested capital—it pays investments managers and whether those fees are fully disclosed. For example, in 2023, TRA reported total investment management fees of only **$24 million**—a fraction of the fees on committed, uninvested capital alone.

Total fees on committed, uninvested capital paid by SBI would be *exponentially greater* than those paid by TRA, an estimated **$360 million** annually—*for doing nothing.*

IX. TRA Brazen Benchmark Bias: $39 Billion Investment Underperformance

According to TRA's financial statements, for fiscal year 2023, the Combined Funds produced a total rate of return of 8.9%. Over the past five years, the Combined Funds generated an annualized return of 8.2%.

Over the last 10-year period, the Combined Funds returned 8.8%. The Combined Funds 20-year annualized return was 8.5%.[58]

Investment returns are prepared using a time-weighted rate of return methodology based upon fair market value, *net* of investment expenses. Combined Funds performance versus a Composite Index (devised by TRA, supposedly comprised of public and private market investment returns) indicates the Combined Funds have outperformed the Composite Index TRA devised on a 1, 5, 10, 20, and 30-year basis by **0.2%** for **each and every period. In our opinion, this 0.2% outperformance year-in and year-out seems virtually impossible.**

To determine the probability of getting five of the exact same return values relative to the index—0.2%, data was obtained from SBI Annual Reports for the years 2014–2023. Over those 10 years a total of 60 return values were disclosed, six values per year. However, only 13 different values accounted for all 60 return values. The returns ranged from –1.2% to 1.5%. The probability of getting the same return value five times was calculated to be **0.0000149**. Such a probability is similar to getting *a straight flush hand in poker* in which there are 36 possible straight flush hands out of 2,598,960 total hands or 0.0000139. Notably, the exact same outcome of five return values of 0.2% **also occurred in 2020.**

The composition of the Composite Index used by TRA is not disclosed in TRA's financial statements. Therefore, it is impossible to evaluate whether it is constructed appropriately to gauge performance of the portfolio. Further, absent such disclosure, it is impossible for stakeholders to determine *if, when or how* the Composite Index may have been changed over time.

The benchmarks for public equity, domestic equity, international equity, fixed income, core bonds are not specified in the Combined Funds 2023

[58] The performance of the Combined Funds disclosed in the SBI 2023 Annual Report is identical to TRA.

performance report. There are no benchmarks whatsoever noted for private equity, private credit, resources, and real estate. Again, this makes it impossible for TRA stakeholders to determine whether the claimed outperformance against the benchmarks reported is accurate.

SBI's Annual Report discloses the composition of its Composite Index for the period ending June 30, 2023 for the Public Equity Composite Benchmark and Fixed Income Composite Benchmark. No composite benchmark is disclosed for its highest cost, riskiest investments in Private Markets, including private equity, private credit, resources, and real estate.[59] Later, the 2023 Annual Report states "The SBI reviews the performance of its private markets investments, relative to inflation, as measured by changes in the Consumer Price Index.."[60] Comparing private markets performance to the CPI's 2.5% annualized performance over the past 30 years is not only *absurdly inappropriate* (given the massive costs and risks related to private markets investments), but *virtually ensures* that private markets (and the SBI as a whole) will handily outperform its Composite Benchmark annually and overtime. If SBI investment staff members are paid bonuses for outperforming the Composite Benchmark, they, too, will benefit.

The Public Equity Composite Benchmark disclosed is highly complex, has changed almost yearly since 2016 and was adjusted quarterly in certain years. Further, it is noted that "Prior to 6/30/2016 the returns for Domestic and International Equity were not reported as a total Public Equity return." The Fixed Income Composite Benchmark is also complex and has been changed repeatedly since 2018. It is impossible for pension stakeholders to determine whether the composition of the shifting

[59] 2023 MSBI Annual Report, pg. 20.

[60] 2023 MSBI Annual Report, pg. 68.

benchmarks is appropriate and whether benchmark performance has been calculated correctly.

In a recent article entitled *Lies, Damn Lies and Benchmarks: An Injunction for Trustees*, by Richard Ennis, the investment consulting pioneer who co-founded the Chicago-based firm Ennis Knupp (now Aon Hewitt Investment Consulting),[61] he concludes that most public pensions, including Minnesota, exhibit benchmark bias when reporting their performance publicly.

Public pension funds and many endowment funds periodically report their investment performance publicly. They accomplish this by comparing the return achieved with that of an ostensibly relevant benchmark, one that supposedly reflects the return of a comparable investment. They use benchmarks of their own devising, typically referred to as strategic (or custom) benchmarks. Most exhibit significant *benchmark bias*, meaning the chosen benchmarks underperform ones that, in fact, better represent a fair economic return given observed market exposures and risk characteristics. **As a result of benchmark bias, the majority of funds give the impression they are performing favorably compared to passive management, when, in fact, they are underperforming by a wide margin**. **Benchmark bias masks serious agency problems in the management of institutional funds. Investment trustees must step up and take control of benchmarking and performance reporting** (emphasis added).

Ennis further observes that today use of passive benchmarks for performance comparisons have largely gone by the wayside in public reporting. Most public pensions use what is commonly referred to as a strategic or custom benchmark (SB), which is often highly customized to fit portfolio circumstances.

Such benchmarks may incorporate numerous asset classes, including for private market investments and other *active* strategies (which immediately defeats the benchmark purpose of evaluating the contribution of active management). Asset classes themselves may have several sub-components, making SBs complex. There are no standards or guidelines for the selection of market indexes. Index returns for alternative investments are typically nebulous, merely representing the past outcomes

[61] As discussed elsewhere, Aon is one of TRA's investment consultants.

of a select group of investors reporting in databases like those of Cambridge Associates, Preqin or NCREIF. Reported private equity returns may be internal rates of return (IRRs), which don't blend easily with time-weighted returns and are subject to manipulation. There is often no explanation in public reporting for the substitution of one index for another. The nature of asset classes and sub-components is often "customized," usually without explanation of what the customization entails or why it occurs. Sometimes component benchmarks are expressed in non-investable terms, such as "CPI +3%." Some funds use the actual recorded returns of private market investments in calculating benchmark returns, which tells us nothing about their impact on performance. SBs tend to be updated frequently, sometimes several times a year; the effect is to cause them to conform to actual portfolio exposures over time. **SBs are invariably subjective in their construction, often complex, ambiguously customized, fluid in composition, opaque, and all but indecipherable to readers of financial reports** (emphasis added). The fund's CIO and/or consultant are responsible for the design and maintenance of SBs. Sometimes investment staff members are paid bonuses for outperforming the SB. Having the CIO and/or consultant, who are responsible for designing and implementing the investment program, also do the benchmarking and reporting is a clear conflict of interest and a sign of weak governance. As a gauge of financial performance, SBs are an economist's worst nightmare.[62]

In another article, *"Cost, Performance, and Benchmark Bias of Public Pension Funds in the United States: An Unflattering Portrait,"* Ennis analyzed the primary performance benchmarks used by 24 large public funds, including Minnesota, in their public reporting. These were benchmarks of the public funds' own devising. He compared the rate of return of empirically-determined benchmarks to the return of the benchmark each fund reported in its annual report for the 10-years ended June 30, 2020, in order to determine benchmark bias. Benchmark bias averaged 1.7 percentage points a year for a decade.

In short, he identified significant *bias* in the returns of benchmarks used by the funds. That is, the principal benchmarks used in public fund

[62] https://richardmennis.com/blog/lies-damn-lies-and-performance-benchmarks-an-injunction-for-trustees

reporting generally produced rates of return that were significantly less than those of benchmarks that, in fact, represented a fair economic return given the funds' market exposures and risk statistics. *Benchmark bias is significant and pervasive,* Ennis concluded.

With respect to Minnesota specifically, for the 10-year-period ended June 30, 2022, Ennis concluded the pension *underperformed* a representative passive benchmark by 0.26%. On the other hand, for the same 10-year-period, TRA boasts it *outperformed* its Composite Index by .40%. A 66-basis point underperformance on a $28 billion-plus portfolio over a decade amounts to *billions.*

In order to estimate the true performance of TRA over the past 30 years, we used the following appropriate benchmarks based upon the approximate asset allocation of the pension over time: 50% S&P 500 Index and 25% U.S. Aggregate Bond Index. With respect to 25% invested in alternative investments, these assets are notoriously difficult to benchmark. The selection of an appropriate benchmark is made difficult by frequent use of leverage, limited liquidity, lack of readily available market values and use of internal rates of return rather than time-weighted rates of return. As a result, we selected the S&P 500 plus 500 basis points.[63] The premium over the market index is designed to account for additional risks involved with private equity such as the high rates of failure of portfolio investments, illiquidity factors (concerning both the relevant investment vehicles in which the pension may invest as well as the actual underlying portfolio investments) and other issues, which add risks to investing in the private markets. As noted below, SBI includes in its Investment Beliefs that "private market investments have an illiquidity premium that the SBI can capture." Therefore, it is appropriate that TRA and SBI benchmarks for private markets investments *should include an illiquidity premium*—which they do not.

[63] We note that this alternative investment benchmark was recommended in a fiduciary audit of the State Teachers Retirement System of Ohio to replace a meaningless (actual performance) benchmark.

With respect to the $28 billion-plus pension, we calculated the underperformance versus the above empirically-determined benchmarks amounted to **$39 billion** over the past 30 years. In short, had the pension been prudently managed to its risk-adjusted benchmarks, it would be nearly **$60 billion** today, providing greater retirement security for participants and saving taxpayers billions.

	5 year	**10 year**	**20 year**	**30 year**
Benchmark	10.8%	11.4%	9.8%	10.1%
Minnesota	8.2%	8.8%	8.5%	8.4%
Difference	-2.6%	-2.6%	-1.3%	-1.7%

In conclusion, in our opinion, the Combined Funds performance versus a Composite Index indicating the Combined Funds have outperformed the Composite Index by **0.2%** for each and every period seems **highly suspect.**

As pension investment consultant expert Ennis has well-documented, benchmark bias in public plan performance reporting is substantial and extensive. However, in a universe of widespread benchmark bias, TRA's remarkable claims of 0.2% consistent outperformance for all periods stand out. In our opinion, TRA's performance results amount to, at a minimum, **brazen benchmark bias**.

X. “Catastrophic” Tax Consequences of Pension Performance Errors

When large public pension plans misstate their investment performance results—intentionally, or unintentionally—the tax consequences can be “catastrophic,” according to tax experts.

In 2021, when internal documents at Pennsylvania’s largest pension fund—the Public School Employees’ Retirement System—revealed a performance calculation error, the FBI and SEC launched investigations, the fund’s board began its own probe and 100,000 public school employees reportedly suddenly faced paying more into the retirement system. The error related to “data corruption” in just a single month—April 2015—over the near-decade-long period included in the performance calculation.

During the December certification, the fund’s annual investment return was pegged at 6.38%. Although this fell short of the pension fund’s assumed rate of return of 7.25%, it barely surpassed the 6.36% threshold needed to avoid an increase in pension payments for 100,000 school workers. The state’s “risk sharing” law means school employees, along with taxpayers, have to contribute more when the pension’s investment portfolio underperforms.

The mistake may have inadvertently prevented an increase in teachers’ pension contributions while at the same time passing the costs onto the commonwealth’s taxpayers. According to The Philadelphia Inquirer, teachers would have had to pay an estimated $25 million a year extra if returns had come in lower.[64]

While the one-time error was small, it falsely boosted the $64 billion fund’s performance over a financial quarter just enough to wrongly lift the fund’s financial returns over a key state-mandated hurdle used to gauge performance.

[64] https://www.ai-cio.com/news/pennsylvania-psers-hires-law-firms-probe-reporting-error/

The board had little choice but to fix the number. A top tax lawyer warned the board that failure to do so would be "catastrophic" and force half a million current and retired school workers to pay future income taxes on pensions immediately.[65]

Since both TRA and SBI have failed to provide any of the documents we have requested, we do not know for certain—and can only estimate—the magnitude of any potential errors or omissions in calculations of performance and investment costs. Further, we do not know the tax consequences, or other legal or regulatory implications (see below) of any pension intentional or unintentional calculation errors.

However, with respect to TRA and SBI, the .02% outperformance is consistent over *all periods of time* (1, 5, 10, 20 and 30 years), not merely a single month in a near-decade-long period. Coincidentally, as discussed further below, the outside consultant ultimately found responsible for the error at the Pennsylvania pension was Aon—a consultant used by both TRA and SBI.

Finally, in 2014, the Securities and Exchange Commission brought securities fraud charges against the state of Kansas stemming from a nationwide review of bond offering documents to determine whether municipalities were properly disclosing material pension liabilities and other risks to investors. According to the SEC's cease-and-desist order instituted against Kansas, the state's offering documents failed to disclose that the state's pension system was significantly underfunded, and the unfunded pension liability created a repayment risk for investors in those bonds.[66]

In 2013, the Securities and Exchange Commission charged the State of Illinois with securities fraud for misleading municipal bond investors about the state's approach to funding its pension obligations. The SEC

[65] https://lebtown.com/2021/06/01/internal-psers-documents-show-how-pas-biggest-pension-fund-got-key-financial-calculation-wrong/

[66] https://www.sec.gov/newsroom/press-releases/2014-164

investigation revealed that Illinois failed to inform investors about the impact of problems with its pension funding schedule as the state offered and sold more than $2.2 billion worth of municipal bonds from 2005 to early 2009. Illinois failed to disclose that its statutory plan significantly underfunded the state's pension obligations and increased the risk to its overall financial condition. The state also misled investors about the effect of changes to its statutory plan.[67] This enforcement action marked the second time that the SEC had charged a state with violating federal securities laws in their public pension disclosures. The SEC charged New Jersey in 2010 with misleading municipal bond investors about its underfunding of the state's two largest pension plans.[68]

Any erroneous pension performance or investment fee calculations—whether intentional or not—may be of concern to the SEC.

XI. Alternative Investment Risks

As indicated earlier, TRA has a 25% target allocation to private markets that includes private equity, private credit, real estate and resources. These are the highest-cost, highest-risk of all investments and the least transparent.

The initial and ultimate question private investments pose for public pension fiduciaries is: When, if ever, and under what circumstances, conditions or safeguards, should public pensions invest in private funds which are *unwilling to submit to public scrutiny*? Is it ever appropriate to invest government workers' retirement savings with "black box" private fund managers who refuse to disclose to pension stakeholders critical information such as the investment strategies, related risks, conflicts of interest, use of leverage and myriad outlandish fees and expenses? How is it possible to verify valuations, investment performance and even

[67] https://www.sec.gov/newsroom/press-releases/2013-2013-37htm

[68] https://www.sec.gov/news/press/2010/2010-152.htm

compliance with law if there is no transparency whatsoever related to these highest-cost, highest-risk investments?

One of the most significant shifts in public pension investing over the past two decades has been the expansion into opaque alternative investments.

According to the Center for Retirement Research at Boston College:

> Overall, state and local plans have increased their holdings from 9 percent in 2001 to 34 percent in 2022… By 2022, the maximum held was over 50 percent and only 5 percent of plans held less than 10 percent."[69]

If TRA and SBI are committing tens of billions private investments utterly lacking transparency presumably the justification is that these black box investments are worth the massive additional risks, i.e., private investments will outperform lower-cost, lower-risk, fully-transparent, public-traded investments. Nevertheless, SBI reviews the performance of its private market investments, relative to inflation, as measured by changes in the Consumer Price Index. Such a benchmark is absurdly inappropriate but virtually ensures that private markets (and the SBI as a whole) will handily outperform its Composite Benchmark. While in 2023, SBI's return on private assets (1.8%) underperformed even the CPI (3.1%), for all other periods, private assets have predictably, substantially outperformed the wildly inappropriate benchmark.

As to whether the shift toward alternatives has helped or hurt pension investment performance, the Center notes the impact of alternatives is complicated by the fact that the reported fair value for many alternative investments is based on appraisals that may differ meaningfully from the true market value. Additionally, plans report performance for alternatives with a quarter lag. As a result, the yearly performance reported for many plans often contains imprecise and outdated valuations of alternatives.

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[69] https://crr.bc.edu/public-pension-investment-update-have-alternatives-helped-or-hurt/

The Center concludes:

> Overall, greater allocation to alternatives helped pension fund returns prior to the global financial crisis, but has harmed them since – with no significant impact when looking over both the pre-and post-crisis periods. Additionally, the reported data from pension funds suggest that greater holdings of alternatives have been associated with lower volatility in annual returns. Unfortunately, it is difficult to know how much of the reduction in the volatility is real rather than the product of lagged and imprecise valuations for some alternative assets.

Further:

> The analysis concludes that the investment performance of pension funds since 2001 has been below actuarial expectations and that plans' increasing reliance on alternative investments has not helped – although it may have dampened volatility.

Finally, we note that, according to the New York Times, "attracted by promises of high returns, many public pension funds have been loading up on private equity but may not fully appreciate the dangers."[70]

> "… reports posted by Oregon and other public pension funds routinely understate these risks, new research has found. The new findings are from Michael Markov, a mathematician who heads MPI, a financial technology company. He provided early warnings about the fraudulently consistent returns in Bernard L. Madoff's Ponzi scheme. I've known Mr. Markov for years. And he now says that, on average, the risks being carried by public pension funds are at least 20 percent greater than they are reporting, largely because they aren't taking account of the true risks embedded in private equity."

With respect to Minnesota specifically, Markov has concluded that the current volatility is about 12%, which is on the "high side. It is also higher than ~9% reported in the financial statements. Even looking at the trailing 10-year window on the risk-return diagram, Minnesota is in the top 10 pensions by risk."

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[70] https://www.nytimes.com/2023/08/04/business/private-equity-public-pension-funds.html?smtyp=cur&smid=tw-nytimesbusiness

Due to the heightened concerns regarding these assets, in April we specifically requested from both TRA and SBI:

"the offering memorandum, subscription agreement and/or investment advisory contract related to each alternative investment (including hedge, real estate, private equity and venture capital funds) in which the fund has invested, including any investment advisory fee waivers or other documents (such as side letters) amending or altering the applicable terms and/or fees."

Our goal in requesting the private market documents was to determine whether these investments were prudent and adequately monitored by pension fiduciaries. TRA responded that it had no such documents related to its alternative investments and SBI—without indicating whether it has any such documents—has provided none to date.

Nevertheless, the risks related to private market investments generally and commonplace industry abuses are well-known. In fact, many of the risks, conflicts of interest involving self-dealing and other abuses are regularly mentioned (but not fully disclosed) in the offering documents—documents which TRA and SBI have been unwilling or unable to provide to us.

In order to educate TRA and SBI stakeholders as to these risks and abuses, we offer the following initial list related to private equity investments.

1. **High-risk, speculative investments**: Private equity offering documents generally prominently state (in capital, bold letters) that an investment in a private equity fund is speculative, involves a high degree of risk, and is suitable only for persons who are willing and able to assume the risk of losing their entire investment.

2. **High-cost, involving myriad opaque asset-based, performance and other fees and expenses:** Private equity investments charge myriad opaque fees and expenses exponentially (10x) greater than traditional stock and bond funds. It is difficult to determine the total cost of

investing in these funds because disclosure of fees and expenses is almost always incomplete.

3. **Illiquid, lacking a public market:** Private equity investments generally do not permit redemptions during the life (generally 10-13 years, but may be as long as 50 years) of these investments. The partnership interests offered are illiquid. No public market for the partnership interests exists and none will be developed. The pension will not be able to redeem or sell.

4. **Lack of transparency:** These investments utterly lack a hallmark of prudence—transparency. The information they provide to investors is limited, often incomplete and impossible to verify.

5. **Largely "unconstrained" and may change investment strategies at any time:** Private equity funds generally disclose specific risks related to investment strategies they may pursue. However, the managers reserve the right to pursue virtually any investment strategy—at any given time. Thus, it is impossible for investors to know for certain at any given time the composition of a fund's portfolio, the appropriateness of the investments and the related risks.

For example, some funds invest in potentially usurious payday loans to the poor, controversial life settlements purchased from the elderly terminally ill and cryptocurrency.

6. **Use of leverage:** Private equity funds generally reserve the right to engage in borrowing, or leverage, on a moderate or unlimited basis. Leverage increases dramatically the risks related to investing in a fund and the degree of leverage may change at any time.

The pension will have no control over and will never know the degree of leverage employed at any given time. That's why it could lose everything overnight.

7. **No assurance of diversification:** Since funds generally reserve the right to invest 100 percent of their assets in a given sector or investment, such as cash, there is no assurance of diversification.

8. **Lack of comprehensive regulation in the U.S:** Private equity funds are not subject to the same degree of regulation as mutual funds and other U.S. registered funds.

9. **Heightened offshore legal, regulatory, operational and custody risk:** Many private equity funds are organized and operate in offshore tax havens, such as in the Cayman Islands, which lack the legal, regulatory and operational safeguards offered in the U.S. Also, fund assets may be held, or custodied, offshore. Funds which are incorporated and regulated under the laws of foreign countries present additional, unique risks which fiduciaries and stakeholders should consider.

10. **Myriad conflicts of interest, self-dealing practices:** Private equity funds generally disclose myriad conflicts of interest involving the investment managers to the funds and others. Managers routinely disclose they may keep the best investment opportunities for themselves or "friends and family."

11. **Valuation Uncertainties**: In private equity funds, the manager determines the value of the investments held in the fund's portfolio. Such valuation affects both reported fund performance as well as the calculation of the management fee and any performance fee payable to the manager. The investment managers are subject to a conflict of interest because they can profit from inflating values. Further, the performance fee structure creates an incentive to the investment manager to engage in speculative investments and thus a potential conflict with the interests of pension investors.

11. **Business practices that may violate ERISA:** Private equity fund offering documents often state that investors agree to permit managers to withhold complete and timely disclosure of material information

regarding assets in their funds. Further, investors in the fund may agree to permit the investment manager to provide certain mystery investors with greater information and the managers are not required to disclose such arrangements to pensions. As a result, the pension is at risk that other unknown investors are profiting at its expense. Finally, the offering documents often warn that the nondisclosure policies may violate applicable laws. That is, certain practices in which the manager engages may be acceptable to high-net-worth individuals (or unknown to them) but violate laws applicable to ERISA-governed private and public pensions.

12. **SEC finds pervasive private equity bogus fees and illegalities:** A majority of private-equity firms inflate fees and expenses charged to companies in which they hold stakes, according to a 2014 internal review by the SEC, raising the prospect of a wave of sanctions against managers (including potentially some of the Fund's private equity managers) by the agency. More than half of about 400 private-equity firms that SEC staff examined charged unjustified fees and expenses without notifying investors.

13. **Private equity transaction fee securities law violations**: Transaction fees charged by private equity funds, sometimes called the "crack cocaine of the private equity industry" (because the fees are not traditionally subject to minimum performance requirements), are increasingly opposed by savvy public pensions.

14. **Private equity monitoring fees tax law violations:** With respect to private equity so-called monitoring fees paid by private equity owned portfolio companies, whistleblower claims have been filed with the Internal Revenue Service alleging that these fees are being improperly characterized as tax-deductible business expenses (as opposed to dividends, which are not deductible), costing the federal government hundreds of millions of dollars annually in missed tax revenue.

15. **Private equity management fee waiver tax law violations**: The IRS has in recent years been examining the propriety of private equity management fees waivers, which have allowed many fund executives to reduce their taxes by converting ordinary fee income into capital gains taxed at substantially lower rates, costing the federal government billions of dollars annually in missed tax revenue.

16. **Private equity under-reporting of massive fees:** The rates of return and hidden costs related to private equity are difficult for even sophisticated investors in these deals to identify. While certain fees associated with private equity funds are widely known — managers typically charge investors 1 to 2 percent of assets and 20 percent of portfolio gains — other charges, including transaction fees, legal costs, taxes, monitoring or oversight fees, and other expenses charged to the portfolio companies held in a fund are less visible—including unauthorized or bogus fees.

In our forensic investigations of over $1 trillion in retirement plans, we have never encountered a pension that fully understood the dangers of investing in alternatives and adequately monitored the investments. Clearly, TRA—which claims it does not hold any of the key investment documents cannot fully understand disclosures it has not even seen and monitor the risks consistent with its fiduciary duties. Whether SBI possesses, has reviewed and monitors these high-risk investments is unclear. However, the fact that the pension is, at best, unwilling to release to the public any documents it may have, is alarming.

XII. "Zombie" Fund Dangers

The life cycle of a private equity fund can be broadly divided into four distinct stages. Fundraising is the first stage of the private equity life cycle and involves raising capital from investors. Private equity firms will seek to raise capital from accredited investors such as high-net-worth individuals, pension funds, and institutional investors. These investors provide the capital required to invest in private companies and generate returns for the fund. The investment stage is the second stage of the private equity life cycle, and it involves identifying and acquiring companies with the potential for growth and profitability. Portfolio management stage is the third stage of the private equity life cycle, and it involves working closely with the companies in which the private equity firm has invested. Finally, the exit stage is crucial to the success of the private equity fund, as it is how investors receive their returns. Private equity firms will have a target return on investment that they aim to achieve, and the exit stage is where they can realize this return. These firms can exit their investment via an IPO, sale to another company, or even another private equity firm.

According to the 2023 TRA financial statements:

> The typical liquidation period for alternative investments ranges from 3 to 12 years. The majority of the distribution is received during the liquidation period, however, it is not uncommon for a minimal amount of the fund to remain open while awaiting final close. As of June 30, 2023, the alternative investments are not expected to be sold at an amount different from the NAV value of the SBI's ownership interest in partner's capital.

The above disclosure, in our opinion, is inadequate in that it may minimize the risks related to extended liquidations in the TRA portfolio. When alternative investments fail to fully liquidate within the stated term of the fund, numerous concerns arise, including whether some or all investment fees will continue to be charged, as well as whether the valuation of portfolio investments and performance reporting has been accurate over the life of the fund.

For example, following the wreckage of the 2009 global financial crisis (GFC), many private equity managers (unable to raise new capital because of poor performance) extended the lives of their troubled funds, milking management fees from investors for mediocre and over-leveraged assets for years. These funds were referred to as "Zombie Funds" by the financial press.[71]

Said Forbes:

Though it's hard to put numbers on how many once thriving private equity managers joined the ranks of the walking dead as a result of the GFC, Triago estimates that there were some 1,100 zombie funds in 2019; that is fee-collecting funds more than 10 years old with assets still in their portfolios, yet run by managers unable to raise a new fund (using a yardstick of 10 years). Funds that began investing in 2008 held **$220 billion in unrealized investments in their portfolios ten years later, more than any other private equity vintage has ever held at that stage** (emphasis added) **…**[72]

Major public pensions have been found to be at risk from Zombie funds:

Even in 2023 some major investors still seem to be suffering from the 2009 Global Financial Crisis-generated spike in zombie funds. In a survey of 10 major public retirement systems in September, Bloomberg found that on average 4 percent of their private equity holdings were still locked in funds that began investing prior to 2009, with one group's concentration - the North Carolina state pension fund - hitting 11 percent. Zombie funds and managers can be a serious drag on private equity performance.[73]

A new class of Zombie funds is reportedly emerging today due to the sharp rise in interest rates:

With the world's most influential benchmark for the cost of debt, the U.S. federal funds rate, rising to 5.25-to-5.50 percent from a floor of zero over the 16 months

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[71] A zombie fund is one that has retained all or some of its assets beyond its intended holding period, and may be struggling to create value in these assets and realize them for a profit. In 2015, private equity consulting firm Preqin defined a zombie fund as any fund with a 2003-2008 vintage, managed by an active firm which has not had any successful fundraising for a follow-up fund since 2008. https://docs.preqin.com/reports/Preqin-Private-Equity-Zombie-Funds-July-15.pdf

[72] https://www.forbes.com/sites/antoinedrean/2023/10/20/no-where-to-run-no-where-to-hide-the-private-equity-zombies-return/?sh=76f6029c7553

[73] https://www.bloomberg.com/news/features/2023-09-24/private-equity-zombie-firms-leave-pension-funds-with-hard-choices

through July - the fastest sustained hike in 40 years - the $9 trillion-in-assets private equity world must brace for a sharp rise in poorly performing portfolios and the emergence of a new class of the walking dead among private equity managers.[74]

According to TRA's financial statements, there are 45 out of 193 Private Equity funds owned by SBI that are over the 12-year liquidation and represent 6% of the Private Equity NAV value. There are 8 out of 35 Real Estate funds owned by SBI that are over the 12-year liquidation and represent 1.2% of the Real Estate NAV value. There are 12 out of 32 Real Assets funds owned by SBI that are over the 12-year liquidation and represent 13.2% of the Real Assets NAV value. There are 13 out of 42 Private Credit funds owned by SBI that are over the 12-year liquidation and represent 7.1% of the Private Credit NAV value.

As noted recently in Institutional Investor:

In recent years, the returns of many top private equity leveraged buyout funds have barely beaten the stock market as some funds can't sell huge chunks of their portfolio, according to a new academic analysis.

For funds between seven and nine years old, "half of the stated asset value consists of unsold deals that are 'marked to market' by the private equity managers," according to a study by Jeffrey Hooke, a senior finance lecturer at Johns Hopkins Carey Business School who focuses on the alternative asset class.

What's particularly striking in Hooke's analysis is how long it is taking private equity funds to sell off their portfolio companies, which is making them even less competitive with, say, an S&P 500 index fund.[75]

In conclusion, TRA and SBI's alternative investments subject to extended liquidations should be examined more fully. There is ample reason to believe, in the opinion of experts, that the delayed liquidations

[74] https://www.forbes.com/sites/antoinedrean/2023/10/20/no-where-to-run-no-where-to-hide-the-private-equity-zombies-return/?sh=76f6029c7553

[75] https://mail.aol.com/d/search/keyword=hooke/messages/APdkVVAdL0a0Zk-HfA6OkHOB3Z4

may be “red flags” for abusive practices, including, but not limited to, fraudulent valuations.

XIII. External Investment Consultants

TRA’s 2023 Financial Statements indicate Aon Hewitt Investment Consulting, Inc., is its general investment consultant and Meketa Investment Group, LLC. serves as a special project consultant. Albourne Partners is the consultant for private markets.

According to a SBI 2023 statutorily required report on investment consulting activities, the SBI seems to retain the same three investment consulting firms, but with Meketa serving in a different capacity. Aon Investments USA, Chicago, IL and Meketa Investment Group, LLC. Portland, OR are the general consultants to the SBI and the annual contract fees for fiscal year 2023 were $602,000 and $495,000, respectively. Albourne America LLC, Norwalk, CT is the consultant for private markets and the annual contract fee for fiscal year 2023 was $1,463,000.[76] Note, fees paid to the private markets consultant for advice regarding 25% of the plan’s assets are greater than the combined fees paid to the other two investment consultants with respect to 75% of plan assets.

A 2023 Legislative Reference Library filing states that as part of their consultant services, Aon and Meketa are available to the SBI Board, staff and Investment Advisory Council (IAC) to provide perspective, counsel and input on relevant investment related issues. Albourne, who is available to the SBI Board and IAC, works primarily with staff to provide back-office support, strategic planning resources, and analysis on private market firms and investments.

[76] The provisions of Minnesota Statutes, Section 11A.27 require the State Board of lnvestment (SBI) to file with the Legislative Reference Library a report on investment consultant activities. As indicated above, information regarding Albourne appears to be incomplete, or more limited than the information regarding Aon and Meketa. https://www.lrl.mn.gov/docs/2023/mandated/231972.pdf

During the period July 1, 2022 through June 30, 2023, Aon and Meketa provided the following reports:

• Periodic background information for evaluating SBI investment managers

• Quarterly Capital Market Outlook Reports

Attached to the Legislative Reference Library filing was an example of the work product Aon and Meketa provided. No Albourne work product was provided in the filing.

Note that there is no reference to any of the three external investment consultants providing any reports, analysis or other information to TRA and in its response to our public records request, TRA denied having any such reports.

As detailed below, our review indicates that all three of the investment consulting firms TRA utilizes are subject to significant—disclosed—potential conflicts of interest.

- **History of Regulatory Concerns Regarding Pension Investment Consultant Conflicts of Interest**

"Pension investment consultants" provide advice to pension plans and their trustees with respect to such matters as: (1) identifying investment objectives and restrictions; (2) allocating plan assets to various objectives; (3) selecting money managers to invest plan assets in ways designed to achieve objectives; (4) negotiating investment advisory fees with managers; (5) monitoring performance of money managers and making recommendations for changes; and (6) selecting other service providers, such as custodians, administrators and broker-dealers.

Many pension plans rely heavily on the expertise and guidance of their pension consultants in helping them to manage pension plan assets. Public pensions, in particular, rely heavily on their pension consultants since these funds generally have lay boards that lack investment expertise.

In late 2003, the staff of the SEC following a recommendation for a high impact pension initiative requested from Benchmark announced an inquiry into conflicts of interest involving investment consultants to pensions, including allegations of "pay to play" practices.

"Pay to play" in the pension consulting context refers to the common practice of investment consultants who are retained on a non-discretionary basis to provide independent objective advice regarding investment managers, requiring or encouraging managers to direct or pay trading commissions and/or other compensation to them in order to be recommended to pension clients.

When consultants recommend managers based upon their willingness to pay compensation to the consultant, as opposed to on the investment merits, they engage in self-dealing and breach their fiduciary duty to place client interests ahead of their own. Substantial harm in the form of excessive risk and fees, as well as diminished investment returns has been found to result. The SEC staff examined the divergent sources of consultant compensation and the related conflicts, whether such amounts and conflicts were properly disclosed, and whether pensions were harmed by such practices.

On May 16, 2005 the staff of the SEC's Office of Compliance Inspections and Examinations issued a report which, in part, concluded that conflicts of interest were pervasive and disclosure practices lacking in the investment consulting industry.[77]

On June 1, 2005 the SEC and U.S. Department of Labor issued a publication entitled "Guidance Addressing Potential Conflicts of Interest

[77] Staff Report Concerning Examinations Of Select Pension Consultants May 16, 2005, The Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission.

Involving Pension Consultants." To encourage the disclosure and review of more and better information about potential conflicts of interest, the DOL and SEC took the unusual step of developing and issuing a set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant. That is, a form of questionnaire was provided for plan sponsors to use in their dealings with their consultants and for consultants to voluntarily make available.[78]

As the DOL noted at that time:

"Findings included in a report by the staff of the U.S. Securities and Exchange Commission released in May 2005 …, raise serious questions concerning whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice they are providing to their pension plan clients… SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plan's investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants also offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of "bundled" services. The SEC examination staff concluded in its report that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries."

Most significantly, conflicts of interest at investment consulting firms were found to result in substantial financial *harm* to plans by the Government Accountability Office in a 2007 report.[79]

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[78] Selecting and Monitoring Pension Consultants, Tips for Plan Fiduciaries, U.S. Department of Labor, May 2005.

[79] Defined Benefit Pensions: Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges, GAO, June 28, 2007.

In its report, the GAO took the extraordinary step of quantifying the harm a conflicted adviser to a plan can cause. "Defined Benefit plans using these 13 consultants (with undisclosed conflicts of interest) had annual returns generally 1.3 percent lower ... in 2006, these 13 consultants had over $4.5 trillion in U.S. assets under advisement," the report stated.

As one observer noted, "That's a $58.5 billion reduction in returns. And this was only a small sample of the pension consulting universe."[80]

Failure to disclose conflicted sources of compensation and the amounts of such compensation among these trusted advisers to sponsors of retirement plans, as well as the potential economic harm to pensions resulting from such conflicted advice, has been well documented by the SEC, DOL and GAO.

In summary, awareness of conflicts of interest involving pension consultants has grown and for well over a decade plan sponsors have acknowledged a duty to investigate such conflicts. Ironically, while disclosure of conflicts of interest in the pension consulting industry has improved over the past 15 years, the conflicts have grown to be more significant than ever.

Since TRA and SBI have failed to provide us with any contracts between the funds and their investment consultants, stakeholders cannot possibly know critical facts such as the range of services the firms provide, whether the firms have adequate insurance coverage to satisfy potential claims involving the massive pensions and whether the pensions have agreed to any limitations on investment consultant liability. Stakeholders cannot possibly determine whether the products and services the investment consultants offer to money managers, and related compensation—which can give rise to serious potential conflicts of

[80] Four-year SEC probe of pension consultants barely yields slap on wrist, Boston.com, October 2, 2007

interest—have been adequately disclosed to plan fiduciaries and are being monitored on an ongoing basis.

- **Aon**

Aon's current Form ADV Part 2A filed with the SEC indicates that the firm and its affiliates may receive compensation from investment managers included in its research database to be reviewed, evaluated, recommended or selected for its clients, related to conferences Aon may sponsor. Aon also provides investment consulting services to investment management firms. "This could create a conflict of interest where Aon recommends such firm's products to our clients," says the firm. In addition to reviewing and recommending other investment managers, the firm is also a money manager itself—an investment adviser registered with the SEC, a Commodity Pool Operator and Commodity Trading Advisor registered with the Commodity Futures Trading Commission and is a member of the National Futures Association.

Aon's disciplinary history[81] includes over a dozen insurance violations involving multiple states. More significant, the company entered into a $190 million settlement[82] with multiple state Attorneys General in 2005 to resolve allegations of fraud and anti-competitive practices. In addition to providing restitution to policyholders, the firm apologized for its improper conduct and agreed to adopt reforms to avoid conflicts of interest. In 2011, the firm paid $14.5 million to the SEC to settle allegations of violations of the Foreign Corrupt Practices Act. In a related

[81] This discussion does not include all state actions and private litigations. For additional information regarding Aon go to https://violationtracker.goodjobsfirst.org/

[82] https://web.archive.org/web/20100215230758/http://www.ag.ny.gov/media_center/2005/mar/aonsettlement.pdf

criminal proceeding, Aon entered into a non-prosecution agreement with the DOJ under which the company paid a $1.764 million criminal fine.[83]

More recently, earlier this year the firm and a former partner paid a $1.5 million settlement to the SEC for misleading their client, the Pennsylvania Public School Employees' Retirement System (PSERS), about the reason for a discrepancy between two different calculations by Aon of PSERS's investment returns for the same period. Said the SEC:

The SEC's orders find that Aon was responsible for calculating PSERS's investment returns for "risk share," a provision under Pennsylvania law that requires public school employees to contribute more to their pensions if the retirement fund does not meet certain investment return rates. If PSERS's investment return rate for the nine-year period ending June 30, 2020 was lower than 6.36 percent, it would trigger risk share, requiring an increase in public-school employees' contributions.

According to the SEC's orders, in June 2020, Aon provided PSERS its quarterly returns for the purpose of estimating PSERS's investment return rate. The orders find that some of the quarterly returns Aon provided to PSERS in 2020 did not match the historical returns that Aon previously provided PSERS for the same periods. According to the SEC's orders, PSERS repeatedly questioned Aon's calculations of the investment returns and asked Aon to investigate a discrepancy between the returns. The SEC finds that, in response to these inquiries, Aon and Shaughnessy, who led the PSERS engagement, failed to adequately investigate that discrepancy, instead providing PSERS with two reasons for the discrepancy that Aon had previously ruled out. The orders further find that Shaughnessy misrepresented to PSERS that the discrepancy was not due to errors when, in fact, she did not know the reason for the discrepancy. According to the orders, in December 2020, Aon and Shaughnessy reported to PSERS that the risk share return rate for that period was 6.38 percent – just high enough to avoid triggering risk share. Ultimately, the discrepancy turned out to be due to errors in the underlying data, and, when the rate was recalculated, the corrected return rate was 6.34 percent – triggering risk share and requiring additional employee contributions.[84]

[83] https://www.sec.gov/litigation/litreleases/lr-22203

[84] https://www.sec.gov/news/press-release/2024-9

PSERS filed a lawsuit against Aon citing breach of contract, breach of fiduciary duty and negligence over accounting errors made in a 2020 risk share analysis. PSERS alleged the firm hurt the pension fund's reputation and caused millions of dollars in damages. The Aon miscalculations led to the resignation of PSERS' executive director, Glen Grell, and its CIO, Jim Grossman, as well as a Department of Justice investigation that lasted more than a year before finding no wrongdoing.[85]

Most recently, Aon Fiduciary Services reportedly resigned as the fiduciary governance adviser to the $92 billion State Teachers Retirement System of Ohio. No explanation for the resignation has been provided to participants.[86] Further, McLagan, a data and analytics company owned by Aon, which consulted to the pension on performance-based incentives, resigned. The company did not provide any reasoning for its resignation. In June, the STRS board blocked staff from getting these performance bonuses.[87]

- **Meketa Investment Group**

Meketa's current Form ADV Part 2A brochure filed with SEC indicates Meketa provides a broad range of investment advisory services that fall generally into three categories: general consulting services, private market advisory services and discretionary advisory services, which includes sub-advisory services to advisors of investment companies. Meketa provides such services to investment company clients on a non-discretionary or discretionary basis. In summary, the firm is subject to a potential conflict of interest in that it both evaluates and recommends

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85 https://www.plansponsor.com/pennsylvania-psers-ends-contract-with-aon-certifies-decrease-in-contribution-rates/

86 https://www.toledoblade.com/opinion/editorials/2024/05/05/editorial-strs-got-fired/stories/20240502009

87 https://www.newsbreak.com/share/3526535739053-chaos-continues-with-ohio-teachers-pension-fund-as-second-advisor-quits

investment managers on a non-discretionary basis and is a discretionary manager itself.

The firm discloses that its discretionary clients may receive preferential treatment versus nondiscretionary clients, such as TRA or SBI, with regard to the *same investment*:

> Where Meketa or MFM serves as the discretionary investment manager, they may have the ability to quickly implement portfolio changes, negotiate the terms that are more favorable to, and may obtain preferential rights or interests in, the same investment held by non-discretionary clients.

With regard to conflicts of interest related to compensation received from money managers, the firm discloses:

> With respect to our private market advisory services, some of our personnel may have the right to serve on the advisory boards of the private pooled investment vehicles in which our clients invest, to provide advice on certain conflicts of interest and related matters. There may be instances where such persons are asked to vote on issues taking the needs of all investors (including third party investors that are not our clients) into account. Such persons may receive reimbursements from the relevant private market investment managers for direct expenses incurred in connection with advisory board activities. In addition to the sub-advisory fees negotiated with RIC clients, Meketa may receive a profits interest grant. Profit interest grants could create an incentive to allocate investments to such RIC clients to the detriment of other clients.

With regard to litigation, in 2020, the trustees of the American Federation of Musicians and Employers' Pension Fund agreed to pay approximately $27 million to settle a class action lawsuit that accused them of making overly risky bets with the pension plan's assets.

According to the legal complaint, the plaintiffs said the plan underperformed its peers because its trustees had set an asset allocation policy that underweighted public equities during an unprecedented bull market, while overweighting higher risk and worse-performing assets.

The settlement imposed on the trustees new governance provisions designed to deter them from taking what the plaintiffs called “wild and excessive” investment risks.

The 2020 settlement also required the trustees to replace Meketa Investment Group as the plan’s outsourced chief investment officer (OCIO) monitor. The trustees retained Meketa as the plan’s investment consultant from 2010 through 2017. The plaintiffs said in the settlement that the “decision to hire Meketa was a disaster” and that the trustees’ decision to retain Meketa as OCIO monitor “reflected their continuing breaches of duty, bad judgment, and resistance to retaining advisers with the requisite degree of independence.”[88]

In 2021, a class action lawsuit was brought on behalf of the New York State Teamsters Conference Pension and Retirement Fund, under ERISA, alleging various breaches of fiduciary duty. Plaintiff alleged that Mekata used its position as the Fund's “nondiscretionary investment consultant to recommend itself for the position of the (Fund's) paid discretionary investment manager” and advised the Fund's Trustees (in its role as nondiscretionary investment consultant) that “the only way . . . to achieve the ‘actuarial return target' was with . . . significantly overweighted allocations of (Fund) assets to the highest risk asset classes.” Plaintiff alleged that this dual role was a conflict of interest and caused the fees the Fund paid to Mekata to “soar from $250,000 to $1.4 million annually.”[89]

In September 2023, the Construction Laborers Pension Plan for Southern California and its Board of Trustees filed an ERISA lawsuit against Meketa Investment Group and Judy Chambers. The lawsuit alleges that Meketa breached its fiduciary duty to the pension by advising it to invest

[88] https://www.ai-cio.com/news/musicians-pension-settles-lawsuit-risky-investments/

[89] https://casetext.com/case/carlisle-v-the-bd-of-trs-of-am-fedn-of-ny-state-teamsters-conference-pension-ret-fund

$30 million in participants' retirement savings in a California-focused Infrastructure Fund to be managed by Onset General Partner, LLC. Onset was a hastily formed company with ties to Chambers. Meketa then essentially abandoned its fiduciary and contractual duties to review and monitor Onset's investment program. When its investment decisions proved to be disastrous, Onset misrepresented the value and performance of the assets under its management. By 2021, Onset represented to the pension that the Infrastructure Fund had a value of almost $55 million, far more than the true value of roughly $12.275 million. Meketa had relied on Onset's valuation without further investigation, according to the allegations.[90]

- **Albourne**

In January 2010, alternatives investment consulting Aksia filed suit in New York State Supreme Court against two of its former employees, alleging that its larger rival, Albourne Partners, recruited them and received and acted upon stolen confidential information about Aksia's clients, research and business practices. In March, Aksia amended the complaint to include Albourne Partners; its U.S. subsidiary, Albourne America; and six Albourne executives. Albourne denied the charges Aksia leveled against the firm in its amended complaint.

Aksia sought at least $40 million in punitive damages, the return of Aksia property, and injunctive relief to prevent Albourne Partners from using the information received from the former Aksia employees, according to court documents. In June 2010, Aksia announced it had settled the trade secrets lawsuit, the day before the trial was to begin.[91]

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[90] https://archive.org/details/gov.uscourts.cacd.898918

[91] https://www.pionline.com/article/20100601/ONLINE/100609988/aksia-albourne-settle-trade-secrets-suit

According to Albourne America LLC's current Form ADV Part 2A filed with the SEC, in addition to evaluating and recommending investment advisers to pensions and other clients, the firm receives compensation from some investment advisers it evaluates or recommends. For example, firm disclosures regarding such payments and related potential conflicts include, but are not limited to, the following:

The Albourne Group receives compensation from a small number of investment managers solely for research and advisory services, which these investment managers use in connection with their evaluations of third party investment products or investment managers. The alternative investment vehicles managed or advised by these Albourne Group investment manager clients are sometimes evaluated for and/or recommended to other Albourne Group clients. In these cases, the Albourne Group takes measures to minimize any potential conflicts of interest.

The Albourne Group advises clients that are affiliates of alternative investment vehicles or have economic interests in the revenues of companies that manage alternative investment vehicles. The Albourne Group also advises clients that are affiliated with, or are providers of, dynamic beta products. In all cases, such alternative investment vehicles or dynamic beta products may be the subject of Albourne's research reports. The client relationships described in this Item… may create the perception that Albourne prefers certain investment vehicles or dynamic beta products because of their affiliation or connection with an Albourne Group client.

To the extent the firm is aware of the types of potential conflicts…, it discloses these potential conflicts of interest in the research reports it produces and may take measures to restrict the clients described above from accessing or reviewing the firm's research reports and opinions on the connected investment vehicle or dynamic beta product. In no case does the Albourne Group receive compensation from investment managers or dynamic beta providers for rating or recommending their investment products to Albourne clients.

The firm discloses that as an alternative investment adviser it has a financial interest in its clients investing in alternatives:

Albourne has a financial interest in its clients maintaining at least some investments in alternative investments because the existence of Albourne's business depends on clients who seek to allocate capital into alternative investments.

With respect to investing in funds recommended to clients, the firm discloses:

> Certain employees of the Albourne Group, however, are invested in investment funds that we conduct research on and/or recommend to clients. These Albourne employees could potentially be motivated to recommend investment funds based on their personal investment interests and not based on independent judgment.

If TRA and SBI's investment consultants have failed to properly disclose to the pensions, conflicts of interest and investment manager compensation arrangements, they may have both failed to comply with their advisory contracts, as well as violated their statutory fiduciary duties.

If TRA and SBI have failed to adequately monitor conflicts of interests involving their investment consultants which could potentially undermine the integrity of the pensions' investment decision-making process, the Boards may have breached their fiduciary duties to safeguard assets and exposed the funds to enormous risks. Further, the Boards may have permitted the investment consultants to enrich themselves by the amounts of such manager compensation, at the expense of the pensions. Again, since TRA and SBI have failed to provide us with any contracts between the pensions and their investment consultants, stakeholders cannot possibly know the answers to these important questions.

XIV. Conclusion

This investigation ends where it began with the key finding that despite any state laws mandating transparency, TRA and SBI are not subject to public scrutiny. As a result, it is simply impossible for stakeholders in Minnesota's state pensions (including participants and taxpayers)—no matter how sophisticated or diligent—to determine whether the $146 billion in assets in such funds are prudently invested, properly valued and safely custodied, or even exist. Stakeholders, regulators and law enforcement should be alarmed.

Further, the aggressive effort by state officials and their allies to undermine the investigation—before it even began—reveals state officials knew, or had reason to believe, a participant-funded investigation conducted by an independent expert (not of their own choosing) posed "many serious risks" and that "TRA's reputation would be questioned."

Key investigative findings include that TRA and SBI failed to monitor and report tens of billions of investment fees and expenses, including hundreds of millions paid to Wall Street for doing nothing. The pensions' performance claims seem virtually impossible suggesting brazen benchmark bias. We note that performance calculation errors, if any, can have catastrophic tax consequences for public funds. Significant private investment and "Zombie fund" risks, as well as investment consultant conflicts of interest were identified.

In light of the serious ongoing concerns identified, it is *generally* advisable for stakeholders to contact the State Auditor, Legislative Auditor and Attorney General. However, in this matter, all three of these state officers are potentially conflicted.

- **Minnesota State Auditor**

The Minnesota Office of the State Auditor primarily audits local governments and also audits local governments by voter petition. However, according to the State Auditor, "that authority does not extend to TRA or other agencies audited by the Legislative Auditor." Further, the State Auditor is a member of the SBI board—the entity which manages TRA's assets.

- **OLA Special Review**

In Minnesota, the OLA generally audits state agencies and statewide organizations including TRA. In addition to the financial audits and program evaluations OLA conducts annually, it also conducts a small number of ad hoc special reviews. Special reviews address specific concerns or allegations and, as a result, they typically have a narrower scope than audits and evaluations. According to OLA's website, "State law gives OLA the authority to conduct special reviews. They are often triggered by concerns brought to OLA by legislators, other public officials, private individuals, or media reports."[92]

Thus, it appears that pension stakeholders could contact OLA regarding the statutory authority and process for a petition or special audit. According to OLA, allegations of misuse of state money, resources or data, can be the basis of a special review. Petitioning OLA to essentially audit *its prior TRA work* might be worthwhile when compelling new information—such as the information in this report—is provided by the petitioner. However, at least one OLA official engaged in efforts to undermine this investigation before it even began which strongly suggests OLA may be subject to a conflict of interest in any state pension matter.

- **Minnesota Attorney General**

The Minnesota Office of the Attorney General provides legal counsel to the TRA and is also a member of the SBI board.

TRA records provided to us in response to a public records request reveal the Attorney General's office participated in efforts to undermine this investigation before it began and may be responsible for TRA's withholding of documents pursuant to the attorney client privilege (since the Attorney General is the pension's legal counsel).

Also, when presented with certain preliminary information in this report months ago for appropriate action, the Attorney General failed to be responsive. His office somehow concluded: "there was no need to meet."

[92] https://www.auditor.leg.state.mn.us/sreview/aboutreviews.htm

Finally, this report was filed with the SEC and provided to the FBI. While the Attorney General appears to be conflicted in this matter, he was provided a copy of our findings.

END REPORT

About Benchmark Financial Services, Inc.

Benchmark Financial Services, Inc., uses cutting-edge financial forensics, coupled with whistleblower insights, to investigate abuses in the money management industry. The firm has pioneered forensic investigations of asset management and has investigated in excess of $1 trillion globally.

Benchmark was founded in 1999 by Edward "Ted" Siedle. Ted is an American attorney, investment banking and securities industry professional, longtime Forbes writer and creator of Pension Warriors by Edward Siedle on Substack.com. The media has referred to him as "the Sam Spade of Money Management," “the Financial Watchdog,” "the Pension Detective" and “the Equalizer.”

Ted is the nation’s leading expert in forensic investigations of money managers and pensions, focusing upon excessive and hidden investment fees and risks, conflicts of interest, fiduciary breaches and violations of law. Prior investigations include the state pensions of Rhode Island, North Carolina, Ohio and Alabama; Shelby County, Tennessee; the cities of Nashville, Chattanooga, Jacksonville, and Cranston; the towns of Jupiter and Longboat Key; corporations including, WalMart, Caterpillar, Boeing, Northrup Grumman, John Deere, Bechtel, ABB, Edison, US Airways Pilots Pension; unions including SAF/AFTRA and New York State Teamsters Pension; and investment firms including, Fidelity, JP Morgan, Sanford Bernstein, and Banco Santander.

Ted was named as one of the 40 most influential people in the U.S. pension debate by Institutional Investor Magazine for 2014 and 2015.

In 2018, Ted secured the largest CFTC whistleblower award in history—$30 million and in 2017, he secured the largest SEC whistleblower award—$48 million—both related to a $367 million JP Morgan Chase settlement that charged the bank with failing to disclose certain conflicts of interest to some of its wealth management clients. In 2016, he obtained the first whistleblower award from the State of Indiana.

Ted is the co-author of *Who Stole My Pension?* along with Robert Kiyosaki, author of the international bestseller, *Rich Dad*, *Poor Dad*, and the author of *How to Steal A Lot of Money—Legally*. His most recent book, *Buried Beneath A Tree In Africa* details his 27-year investigation into his father's disappearance and murder in Uganda, East Africa in 1971.