

State Employees' Retirement System
Testimony
House State Government Subcommittee on
Public Pensions, Benefits, and Risk Management
April 5, 2022

Chairman Miller, Chairman Grove, esteemed members of the committee – we are pleased to have the opportunity to testify and provide information regarding the efforts of the State Employees' Retirement Board and the State Employees' Retirement System to review, consider and incorporate governance best practices to improve the effectiveness of the Board and SERS staff to better serve the needs of its members and participants, with corresponding benefits for the taxpayers of Pennsylvania.

Development of Governance Policy Manual

In October 2015, Funston Advisory Services LLC was engaged by the SERS Board to perform a comprehensive governance review that identified and analyzed key considerations in formulating an effective governance structure. One key finding of this effort was the need for the drafting of a comprehensive governance policy manual to provide a framework with a specific focus on the role of the SERS board and its committees, including the development of policies and procedures to be based on industry best practices in general, and also specific to SERS' organizational structure.

The review led to the issuance by Funston of a report dated March 4, 2016 (*For the Benefit of Pennsylvania: Strengthening SERS Oversight SERS Board and Organizational Structure Review: Final Report*), which resulted in SERS creating a SERS Board Governance Policy Manual. The SERS Governance Policy Manual contains the principal policies and procedures developed and used by the Board, its committees, and SERS staff in carrying out their fiduciary duties and responsibilities to the members of the SERS Defined Benefit Plan and Benefits Completion Plan, and to the plan participants of the Defined Contribution Plan and Deferred Compensation Plan.

The Governance Policy Manual includes the following:

- Actuarial Services Policy
- Amended Bylaws, with the establishment of the following standing committees:
 - Audit, Risk and Compliance Committee
 - Board Governance and Personnel Committee
 - Finance and Member and Participant Services Committee
 - Investment Committee
 - Securities Litigation Committee
- Committee charters for the standing committees
- Board Education Policy
- Board Self-Assessment Policy
- Communications Policy
- Fiduciary Review Policy

- Performance Review Process for CIO, as amended
- Performance Review Process for SERS Executive Director
- Policy for Indemnification of Board Members, Designees, Officers and Employees
- Policy on Placement Agent Disclosures
- Position Descriptions:
 - Board Chairperson and Assistant Chair Positions
 - Board Member Position
 - Committee Chair and Assistant Chair Positions
- Recusal Policy
- Referral of Investment Opportunities and Service Provider Candidates; Related Communications; Undue Influence
- SEC “Pay-to-Play” Rule Compliance and Reporting Policy
- Securities Litigation Policy
- SERS Ethical Conduct Policy
- Board Travel Policy

Subsequent to the establishment of the Governance Policy Manual in 2018, the Board and staff have continued to expand the processes, policies, and other components of the manual, with the inclusion of the following:

- Strategic Planning Process
- Insider and Personal Trading Policy
- State Employees’ Retirement Board Compliance Program Charter
- Committee Work Plan Procedures Policy

As an outgrowth of staff work on the SERS Governance Policy Manual, a renewed focus on the SERS compliance program and improving those processes was undertaken. The purpose of the SERS compliance program is to:

- Promote and foster an organizational culture of integrity, ethical decision-making and compliance with applicable laws, policies, procedures, codes, and other legal requirements in fulfilling the Board’s mission and fiduciary responsibilities;
- Establish a compliance function, with a Chief Compliance Officer monitoring, advising, reviewing and reporting to the Board on compliance activities;
- Assure that the Board and its employees conduct business with the highest standards of ethics and integrity; and
- Establish an infrastructure that provides additional assurance that SERS’ operating divisions comply with applicable laws, policies, procedures, codes, and other legal requirements.

Consistent with the Board’s commitment to the highest ethical standards and transparency, the Compliance Program is designed to support the Board and SERS’ commitment in fostering a proactive culture of excellence and integrity in its stewardship of the system on behalf of its members and of the Defined Contribution Plan and Deferred Compensation Plan on behalf of the plan participants. The program is designed as a dynamic process, to identify and alert the Board and SERS staff of any existing or newly identified emerging ethical and legal risks.

Additionally, the Board Travel Policy was amended on December 8, 2021, to merge the Board’s Travel Policy with an administrative travel policy governing staff travel, which included the following provisions:

- Prohibits third parties from furnishing business travel arrangements
- Requires adherence to the travel and subsistence allowance monetary limits of Management Directive 230.10, from which SERS had been exempted.
- Specifies the requirements pertaining to out-of-state and international business travel

SERS 2021 Fiduciary Review and Board Self-Assessment

In furtherance of the Board Governance Policy Manual's *Fiduciary Review Policy* and *Board Self-Assessment Policy*, which both provide for periodic reviews of the Board's governance policies and practices, in January 2021, the Board again engaged Funston to review the Board's fiduciary and governance practices. This review was undertaken to improve the effectiveness of the Board in serving the needs of SERS' members and the Defined Contribution Plan and Deferred Compensation Plan participants.

Pursuant to the *Fiduciary Review Policy*, every three or four years the Board is to select and contract with a qualified independent consultant to conduct a review of the Board's performance of its duties, identify developing best practices and make recommendations to the Board for improving its governance, policies and procedures.

The purpose of the *Board Self-Assessment Policy* is to provide a process by which the Board can regularly review and assess its performance and to identify subject areas that may be appropriate for educational/training sessions, pursuant to the *Board Education Policy* and that a third party may be engaged to facilitate the self-assessment and follow-up improvement planning.

At the April 28, 2021, Board meeting, the Board approved Motion: 2021-26 to accept Funston's *SERS Fiduciary Review and Board Self-Assessment – Final Report*, which included reports and recommendations in the following areas:

1. A fiduciary and governance review of the Board's performance of its duties in the following four task areas:
 - Non-Economic Investment Requirements (in-state managers, minority and women-owned programs, etc.)
 - The Asset Liability Matching Process
 - Legislative Positioning: Reactive and Proactive
 - Investment Manager Selection / Due Diligence / Monitoring / Termination
2. A self-assessment of the Board in ten areas of governance, which included:
 - Governance Structure
 - By-laws, Charters, and Policies
 - Board Meeting and Operations
 - Powers Reserved for the Board and Delegations
 - Board Oversight and Independent Reassurance
 - Board Committees
 - Board Education and Development
 - Board Interactions with Staff
 - Evaluation of Board Direct Reports
 - External Advisors.

The Board further directed SERS staff to engage with the appropriate standing committees of the Board to: (a) review the Final Report's recommendations, and (b) make recommendations to the Board for action, as appropriate.

Funston noted in its report that the Board has made significant improvements in its governance structure, policies, and practices over the past five years since its last governance review in 2015 and should be commended for its progress.

The Board's self-assessment had high effectiveness ratings, but also identified some areas for continuing improvements in governance.

The recommendations were put into an implementation roadmap developed with SERS staff and staff is working with the Board's committees in reviewing the recommendations, many of which have already been implemented.

Governance Structure Recommendations

We do wish to highlight the following Funston recommendations, which SERS fully supports:

- **Give the SERS Board greater flexibility regarding procurement, including the ability to establish its own procurement policy.**
- **Increase the SERS Board's discretionary authority regarding budget, complement, classification, compensation and contracting, procurement process and authorities.**

The desirability of giving the SERS Board greater flexibility regarding procurement policy and greater discretionary authority regarding budget, complement, etc., has been discussed in prior forums, perhaps most notably in SERS' testimony at a hearing of the Public Pension Management and Asset Investment Review Commission, created as part of Act 2017-05.

At a hearing in October, 2018, in answer to a question from the commission about what the General Assembly can do to help SERS improve efficiencies and reduce costs, SERS executives noted that the SERS Board and agency staff stand in direct fiduciary status to the fund and that the recommendations being made were consistent with the fiduciary duties and responsibilities of the SERS' Board and staff in administering the fund for the exclusive benefit of the members, and with the skill and care that a person familiar with such matters would exercise.

Specifically, it was proposed that:

- The Board be given the decision-making authority for organization, position complement, and compensation for management employees in place of the Commonwealth's Executive Board.
 - Having maximum flexibility in the ability to increase our staffing complement will allow us to continue with the cost-saving improvements that are already underway. The addition of high quality, specialized staff in the investment and investment accounting areas will help us to improve our investment and financial operations and audit capabilities, and to reduce costs.
 - Increasing our staffing complement will also enhance our ongoing effort to implement and grow our internal asset management capabilities. We have seen the promise that this effort holds – from our own experience, and in learning about the actions taken by other elite public pension funds.

- Having control over the ability to set compensation levels allows the board to attract high quality expertise.
- The Board be given greater flexibility to more efficiently procure goods and services.
- The Board be given the ability to determine its budget, without having the Office of the Budget approve or alter the Board's budget requests.

In addition to the specific items listed above, members of the commission were reminded that there are consequences to imposing administrative limitations on the ability of the SERS Board to efficiently administer the fund and manage SERS' operations, and substantive restrictions on how the SERS Board can invest the assets of the fund. Administrative burdens or substantive restrictions can, to a greater or lesser degree, increase costs or reduce the ability of the Board to achieve desired investment returns. This applies to both current and future statutory regimes. In short, it was posited that the Board should be given maximum administrative flexibility and investment authority in its ability to satisfy its fiduciary duties and obligations.

This perspective provided three years ago to the pension review commission is consistent with the Funston recommendations listed above.

Again, thank you for giving us the opportunity to share with you the governance initiatives undertaken by SERS and the SERS Board. We welcome any questions from the members of the subcommittee.

State Government Subcommittee on Public Pensions, Benefits and Risk Management

Board Governance Project Overview

Pennsylvania
Public School Employees' Retirement System

April 5, 2022



Overview

- Funston Advisory Services LLC (FAS) and Engagement Team Introductions
- Project Scope
- PSERS Board, Advisor and Staff Engagement
- Project Phases, Timing and Board Involvement
- Final Recommendations
- Questions

Funston Advisory Services LLC (FAS) Overview

FAS has conducted numerous governance, risk, compliance and investment operations reviews of public retirement systems over the past ten years. We have also published extensively and offer an on-line governance education resource (Board Smart®) for trustees and executives.

State / Federal Systems

- California Public Employees' Retirement System
- Delaware Public Employees' Retirement System
- Employees' Retirement System of Rhode Island
- Employees' Retirement System of the State of Hawaii
- Indiana Public Retirement System
- Maryland State Retirement and Pension System
- Missouri Department of Transportation & Missouri State Highway Patrol Employees' Retirement System
- New Mexico Public Employees Retirement Association
- New York State Comptroller – Common Retirement Fund
- Ohio Police and Fire Pension Fund
- Oregon Investment Council
- Pennsylvania Public School Employees' Retirement System
- Pennsylvania State Employees' Retirement System
- School Employees Retirement System of Ohio
- South Carolina Public Employee Benefit Authority
- South Carolina Retirement System Investment Commission
- State Board of Administration of Florida
- State Teachers Retirement System of Ohio
- Teachers Retirement System of Texas
- Trust Fund for the People of the Federated States of Micronesia
- Utah Retirement Systems
- Wyoming Retirement System

County and Municipal Systems

- Fairfax County (VA) Retirement Systems
- Los Angeles County (CA) Employees Retirement Association
- Milwaukee County (WI) Employees' Retirement System
- Montgomery County (MD) Public Schools Retirement Trust
- New York City Comptroller – Bureau of Asset Management (NY)
- San Francisco Employees' Retirement System (CA)

FAS PA PSERS Engagement Team

Team Member	Role	Background Highlights
Rick Funston	Project Leader	CEO Funston Advisory Services LLC, Deloitte former National Practice Leader Governance and Risk Oversight, created concept of risk intelligence in 2001, principal author “Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise” Wiley & Sons 2010, and editor “One of a Kind – A Handbook for Public Retirement System Trustees”.
Randy Miller	Project Manager	COO Funston Advisory Services LLC, Deloitte Consulting LLP, former National Partner Strategy and Operations. Has led numerous reviews of public retirement systems and leads the FAS InGov® benchmarking service.
Keith Johnson	Legal Advisor	Formerly Head of Reinhart Boerner Van Deuren s.c.'s (Reinhard Law) Institutional Investor Legal Services. Former General Counsel, State of Wisconsin Investment Board, Former President of National Association of Public Pension system Attorneys.
Jon Lukomnik	Senior Consultant	Former Deputy Comptroller New York City Bureau of Asset Management, Member of the Deloitte Audit Quality Advisory Committee, the Standing Advisory Group of the Public Company Accounting Oversight Board, and the Board of Trustees of the Van Eck family of US mutual systems (Chair Audit Committee), insurance trusts, and European UCITs. A senior fellow for the High Meadows Institute and the Pembroke Visiting Professor of International Finance at the Judge Business School, Cambridge University, during January – March 2020.
Lisa Morris	Senior Consultant	Formerly Executive Director of Ohio School Employees Retirement System. Senior consultant with Funston Advisory Services. Senior Consultant on numerous reviews.
Tiffany Reeves	Legal Advisor	Shareholder with Reinhart Boerner Van Deuren s.c. (Reinhard Law) in the Employee Benefits and Institutional Investor Services practices, having joined in 2017. Previously, Tiffany was Deputy Executive Director and Chief Legal Counsel at the Chicago Teachers' Pension system (CTPF).

Project Scope

Commissioned by the Pennsylvania School Employees' Retirement System Board (PSERSB) in 2019. The project scope included the following 8 subject areas:

1. Governance structure
2. By-laws, charters, and policies
3. Powers reserved for the Board and delegations
4. Board meetings and operations
5. Board oversight
6. Board committees
7. Board education and development
8. Evaluation of Board direct reports

The scope did not include an assessment of the establishment of a combined investment system, asset allocation or investment operations, a forensic review, an audit or an operational review.

Process

Phase 1 – Data Gathering

- Document review
- Interviews
- InGov® (a proprietary governance benchmarking tool)

Phase 2 – Analysis

- Presentations and workshops with the Ad Hoc Governance Committee
- Progress reports to the full Board

Phase 3- Report

- Preliminary Draft
- Final

The Governance Review began in November 2019, our preliminary report was completed by May 2021 and, at the request of the Board, the final report was delayed until October 2021.

Recommendations

- In total, FAS made 25 major recommendations with detailed implementation guidance.
- We used our proprietary framework of [Powers Reserved for the Board](#) to organize our recommendations.

Governing Structure / Legislation

Appointments to the PSERS Board



1. Develop alignment and improve the Board's focus on setting direction and policy and prudent delegation.



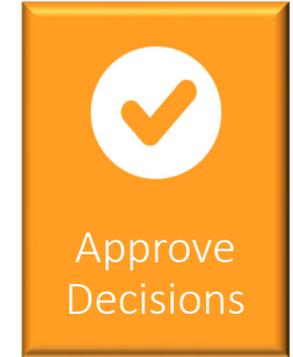
2. Improve the timeliness and insightfulness of information for decision-making and the Board's oversight of the execution of direction within policy.



3. Verify then trust. Build and restore trust by improving independent verification and independence of the Board's advisors.



4. Improve the way the PSERB and its committees conduct the business of the Board in its meetings and operations.



5. Improve the robustness and efficiency of the processes for obtaining Board approval of key decisions.

1. Develop alignment and improve the Board's focus on setting direction and policy and prudent delegation.
 - 1.1 Develop a strategic plan and improve stakeholder communications.
 - 1.2 Develop a unified direction on PSERS' strategic asset allocation.
 - 1.3 Organize and streamline policy setting.
 - 1.4 Clarify roles, responsibilities, authorities and accountabilities of the Board and professional staff.
 - 1.5 Improve the Board's evaluation process for PSERS' Executive Director / Chief Investment Officer.

2. Improve the timeliness and insightfulness of information for decision-making and the Board's oversight of the execution of direction within policy.
 - 2.1 Improve the Board's oversight through exception reporting.
 - 2.2 Improve oversight of performance and risk management.
 - 2.3 Improve oversight of cyber security and information security.

3. Verify then trust. Build and restore trust by improving independent verification and independence of the Board's advisors.

3.1 Improve independent verification / internal audit capabilities.

3.2 Enhance the mandate of the audit and compliance committee.

3.3 Investment risk and investment compliance.

3.4 Improve overall compliance.

3.5 Improve / ensure the independence of external advisors.

4. Improve the way the PSERSB and its committees conduct the business of the board in its meetings and operations.
 - 4.1 Clarify leadership roles and responsibilities.
 - 4.2 Streamline the format and content of the Board's meeting agendas, minutes, and related materials.
 - 4.3 Clarify the PSERSB's use of executive sessions as related to the Sunshine Act.
 - 4.4 Improve communications and transparency of the Board, staff and external stakeholders.
 - 4.5 Board meeting frequency and duration (excluding the current situation) is consistent with peers.
 - 4.6 Improve the functionality of the board portal to improve trustee insight and access to information.
 - 4.7 Clarify designee participation in meetings.
 - 4.8 Streamline Board committees.
 - 4.9 Streamline PSERS's Bylaws and create/refine charters.
 - 4.10 Continue to improve Board education and development.

5. Improve the robustness and efficiency of the processes for obtaining Board approval of key decisions.
 - 5.1 Improve Board oversight of investment manager hiring or termination.

6. Governance Structure / Legislation

- 6.1 Stagger member terms to the extent feasible.
- 6.2 Identify preferred experience, skills and diversity attributes that would improve overall composition of the Board.

Questions