

PENNSYLVANIA  
STATE EMPLOYEES' RETIREMENT SYSTEM  
(SERS)

***For the Benefit of Pennsylvania:  
Strengthening SERS Oversight***

***SERS Board and Organizational Structure Review:  
Final Report***

March 4, 2016



**Funston Advisory Services LLC**



PA SERS Governance  
Findings, Conclusions and Recommendations

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# PA SERS Governance Findings, Conclusions and Recommendations

## Overview

### Purpose

This review was commissioned by the State Employees' Retirement Board (the "Board") of the State Employees Retirement System of Pennsylvania (the "Retirement System"). The purpose of the project was to find ways to improve the effectiveness of the Board to better serve the needs of the Retirement System's participants and employers, with corresponding benefits for the taxpayers of Pennsylvania.

Section 5931 of the State Employees' Retirement Code, 71 Pa. C.S.A. §§5101 *et seq.*, (the "Retirement Code"), imposes fiduciary duties of prudence and loyalty on Board members. The Board is expected to oversee management of fund assets with the care, discretion and intelligence of a prudent expert that is investing for the long term. In addition, the Board must act for the exclusive benefit of all fund participants, not for the Board members' own profit or to serve interests of their constituents or appointing authorities. Board governance structures, policies and practices should be designed to facilitate implementation of these legal obligations. Peer comparisons can be helpful, provided the unique circumstances of each pension fund are recognized.

Attention to the delegation of responsibility and authority are critical areas of focus for fiduciaries. A primary role of the Board is to ensure there are capable people, processes and systems to operate the organization consistent with its mandate and Board policies and directions. The Board should also obtain reasonable and timely assurances from its executives and reassurance (from those independent of management) that management's assurances are reliable. Such reassurance forms an important foundation that enables the Board to responsibly delegate authorities to its executives with confidence.

### Background

This review follows a series of events that have impacted the organization. They include the departure of a long-time chairman of the board after more than 20 years of service, enactment of Retirement Code changes, extensive staffing turnover in key positions, and multiple inquiries into allegations of misconduct by a former CIO which found no wrong-doing but eroded public confidence in SERS and placed the entire organization under severe stress.

SERS is now building its capabilities to protect the future financial security of Retirement System participants to the benefit of the Commonwealth of Pennsylvania. The Board commissioned this review as part of its commitment to adopt leading governance policies and practices.

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## Scope of Work

Draft a comprehensive governance policy manual in conjunction with developing recommendations pursuant to a review that addresses the following tasks:

### **Board Structure**

1. *Evaluate and make recommendations as to the board structure including the need for a vice chairman or other governing board member in the absence or disability of the Chairman.*
2. *Evaluate the existing committee structure and make recommendations for additional standing and ad hoc committees as well as the composition of members on those committees, their role and authority.*
3. *Address how committee issues and discussion gets deliberated, are brought to the full board's attention and action, while avoiding a verbatim replay of the committee discussion.*
4. *Evaluate and make recommendations as to the length of term and rotation of committee members.*

### **Board Policies and Reporting**

5. *Evaluate and make recommendations to retention or modification of existing bylaws and committee charters.*
6. *Evaluate and recommend policy that addresses trustee communication with external parties.*
7. *Evaluate and recommend policy regarding the search process for key service providers.*
8. *Evaluate and recommend board expectations concerning the types and frequency of routine reports it is to receive from various sources.*
9. *Evaluate and establish policies that ensure actions taken by the board are consistent with applicable laws and fiduciary duties of the board and staff, including gifts, travel, insider trading and code of conduct.*

### **Performance Evaluation**

10. *Review the process by which the executive director will be evaluated.*
11. *Review the process by which the chief investment officer will be evaluated.*
12. *Establish a process whereby the trustees may conduct self-analysis to ensure continuous improvement of the board's effectiveness.*
13. *Consider the need for a periodic, independent evaluation and/or assessment of its performance.*

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14. Consider the issue and make recommendations regarding a minimum requirement of each trustee's attendance at board meetings and key board committee meetings, absent extraordinary circumstances.

**Other Recommendations**

15. Additional recommendations to policy as identified by the Contractor as deemed necessary and as approved by SERS Audit Committee.

Process and Timing

*Phase 1: Analysis*

The first phase, Analysis, began October 5, 2015 and is now complete. Activities included:

- 360° Governance self-assessment survey
- System profile questionnaire and benchmarking analysis
- Board members and staff Interviews
- Document reviews
- Preparation of a preliminary discussion document

At the conclusion of the first phase, the FAS team provided a discussion document with preliminary findings, conclusions and recommendations. This document was reviewed with the Audit Committee of the Board and feedback was provided to the FAS project team.

*Phase 2: Verification*

Based upon initial feedback from the Audit Committee, a revised document was prepared and discussed to refine our recommendations. In some cases, there were refinements in response to Audit Committee feedback and additional information received from SERS. All detailed findings, conclusions and recommendations are contained in the main body of the report.

*Phase 3: Finalization*

For the February Audit Committee and March Board reviews, the FAS team prepared two documents:

1. A final report which includes a further refinement of prior discussion documents
2. A draft Governance Policy Manual which provides the foundation for the SERS staff and Board to implement the recommendations of this report

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This final report document has been prepared after receiving feedback from a special Board meeting on March 3 2016 where the Audit Committee, with support from FAS, presented its recommendations to the Board.

## Summary of Recommendations

### **Recommendation 1: Board Assistant Chair**

The Board should revise its bylaws to provide for having the SERS Chair, in consultation with the Board, select a Board Assistant Chair to:

- a. Lead the Board when the Chair is absent and also not able to participate telephonically
- b. Assist the Chair in leading the Board and taking on certain duties as specified by the Chair

The proposed duties for a Board Assistant Chair are described in Appendix A. This recommendation will not impact the current appointment of the Chair by the Governor or the duties of the Chair.

### **Recommendation 2: Committees of the Board**

In order to improve overall effectiveness, the Board should:

- a. Revise its bylaws and create a Governance Policy Manual to describe:
  - i. A more formalized committee structure
  - ii. An explicit process for selecting each committee chair and members for a specified term
  - iii. A clear charter for each committee with delegated responsibilities and reporting requirements

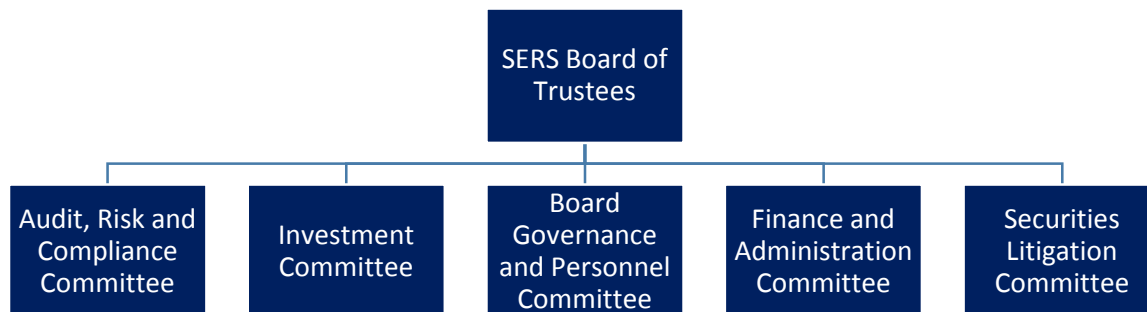
The committees should fully analyze and vet recommendations which they would then present to the full Board. Except as has already been delegated to the Securities Litigation Committee, committees would not be empowered to make final decisions for the Board.

- b. Since the current Audit Committee charter includes oversight of risk management, designate it as the Audit, Risk and Compliance Committee
- c. In addition to the existing Audit Committee, the Board should create the following new standing committees:
  - i. Investment Committee which could additionally take on corporate governance program oversight and responsibilities of the Deferred Compensation (DC) Committee
  - ii. Board Governance and Personnel Committee
  - iii. Finance and Administration Committee
- d. The Securities Litigation Committee should be formalized as a standing committee which meets on an as needed basis
- e. As a process for selecting each committee chair and committee member:

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- i. With the Board's advice, the Board Chair should appoint Board members (including member designees) to serve on each committee
  - ii. Each committee should elect a chair for a two-year term; with the exception of the Board Governance and Personnel Committee, the Board chair would not be eligible for chairmanship of a committee but could be a member of multiple committees (see Appendix B for a description of the proposed duties of committee Chairs and Assistant Chairs)
  - iii. The Chair of each committee should appoint one of the committee members as Assistant Chair, with the Committee's advice and consent
  - iv. Non-committee members of the Board should be welcome to attend committee meetings as non-voting observers
- f. The charter for each committee should include an odd number of members; with the exception of the Investment Committee, which could have up to seven members, each committee should have a minimum three and a maximum of five, a process for calling meetings and setting agendas, a minimum number of meetings annually (if applicable), responsibilities, and reporting requirements.
- g. The Board should delegate the authority needed by each committee to exercise its responsibilities and make recommendations to the Board.
- h. A process for individual Board members to request pre-meeting assistance in understanding meeting materials could be established to improve committee effectiveness.

Examples of typical responsibilities for each committee are included in Appendix C: Example Committee Charters. The proposed committee structure is shown below:



**Recommendation 3: Board and Committee Agendas**

Each committee chair should share the upcoming committee agenda in advance with the full Board during regular Board meetings. The issue calendar for the Board and each committee could be broadly formulated on an annual basis as part of the strategic planning process (see also Recommendation 15.4). The committee chair should also report to the Board on the committee's discussions and



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deliberations for significant issues. The committee's recommendations should be presented to the full Board to ensure that each Board member is adequately informed. At the same time, each Board member has a responsibility to stay apprised of key issues being addressed by the various committees.

### **Recommendation 4: Committee Terms**

The SERS Board should adopt staggered two-year committee terms, consistent with the two-year terms of House members serving on the Board, with the possibility of a member being appointed to two additional consecutive terms on the Investment Committee and one additional consecutive two-year term on all other committees. Committee term limits could be waived in individual cases by the Board chair when determined appropriate for maintaining a suitable level of experienced members on a committee. Additionally, if a Board member's time permits, he or she could serve on more than one committee. As a general policy, each Board member should participate as a member of at least one committee.

### **Recommendation 5: Governance Policy Manual**

This governance project developed a draft foundational Governance Policy Manual (GPM) with SERS staff and the Audit Committee which includes policies for those areas included in the scope of the RFP, which are a subset of those typically found in a comprehensive GPM. The policies should include requirements that Board Members and Designees report all material contacts with existing or prospective service providers and investment opportunities, avoid substantive communications with known current procurement candidates and provide for development of a single unified strategic planning process that integrates investment and operational functions in one report. Upon completion of this initial version of the SERS GPM, the Board should direct the Executive Director, in consultation with the Chief Counsel, to consider if additional topics should ultimately be covered in the GPM.

The Board should build upon these foundational policies over time as appropriate. Responsibility for recommending approval of and monitoring policy development should be delegated to the Board Governance and Personnel Committee. The Board's policies should be reviewed and updated periodically (e.g., annually or biennially).

The draft foundational Governance Policy Manual and related policies will be submitted separately with draft revised bylaws. (See Recommendation 9; Bylaws and Committee Charters and Recommendation 12; Board Self-Assessment.)

### **Recommendation 6: Communications Policy**

The SERS Board should consider a two-way communications policy which addresses stakeholder engagement and communications requirements and responsibilities. The policy should address who can speak on behalf of the Board and the System. For example, there are typically four main points of communication:

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- Communications Director (should be primary point of contact)
- Chair (or another Board member designated by the Chair)
- Executive Director
- Chief Investment Officer

Communications skills should be addressed as part of performance evaluation of each spokesperson. (See also Scope of Work 10 and 11 re: Evaluation of the Executive Director and the Chief Investment Officer.)

SERS should also develop a proactive two-way stakeholder communications plan. Such a plan should begin with a definition of what SERS wants to be known and admired for and compared to how various stakeholders (employees, employers, beneficiaries, legislators, taxpayers etc.) actually perceive SERS. One objective of the plan should be to convey information to stakeholders and close any gaps.

### **Recommendation 7: Procurement Process**

To facilitate timely selection of other key non-professional administrative or technical investment support services and acquisition of key information systems, SERS should develop a modified procurement process. The modified process should allow acceptable transparency and objectivity, improve the ability to evaluate, select and implement new providers and information systems, as needed, and include documentation to allow oversight on a post-purchase audit basis (rather than imposing pre-purchase restrictions).

### **Recommendation 8: Reports to the Board / Information for decision-making that provide consistent data sets in reporting and format which will allow for ease in comparison**

Working in collaboration with the SERS executive staff, the Board should streamline the reporting it currently receives. This could include expansion of SERS' online board documents system for use by Board members. Each Committee should review current reports pertinent to its area of responsibility with the goal of improving insight for risk intelligent decision-making. The process might include:

- a. Require that executive summaries which provide insight into the issue, the options available and the thought process behind any recommendation for all decision requests to the Board. The same summary format, with consistent formatting for presentation of data, if applicable, should be used by Committees, staff and consultants. The executive summaries could include, for example:
  - i. Issue/ Background
  - ii. Options / Pros and Cons
  - iii. Risks of action / inaction
  - iv. Areas of disagreement between staff and consultants, if applicable
  - v. Recommendation

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- b. A biennial “sunset” review of all reports to eliminate reports deemed unnecessary
- c. Simplification or restructuring of reports which are overly complex
- d. Identification of thresholds or triggers for issues (financial, legal, personnel, operational, reputational, etc.) or non-recurring reports that must be brought to the attention of the Board; staff should bring issues first to the corresponding committee chair or the Board Chair, as appropriate, and to the attention of the full Board at its next meeting

A common list of questions to be routinely asked in relation to a recurring decision, e.g., manager selection or budget approval, should be developed. The Executive Director should be designated as the contact for initiating requests for information from staff.

**Recommendation 9: Bylaws and Committee Charters**

The Executive Director should coordinate with the Chief Counsel and work with the Board Governance and Personnel Committee to update the bylaws and committee charters and develop policies and reporting mechanisms in accordance with fiduciary and legal compliance principles. Related training during the onboarding process for new Trustees, along with regular refresher sessions, should be provided. Board training should be coordinated with Board self-assessment and skills development processes and should include familiarization with the SERS Governance Policy Manual. Relevant training obtained through other sources could be recognized in any training mandate. Periodic reviews and updates of policies, as well as strong audit and compliance programs, are important aspects of independent reassurance and pension fund governance as robust policy statements are only useful if implemented.

Draft bylaw changes will be submitted separately with the draft Governance Policy Manual and policies. (See Recommendation 5: Governance Policy Manual.)

**Recommendation 10: Executive Director Performance Evaluation**

The new Executive Director evaluation process adopted by the SERS Board appears to be a sound approach which should be effective if implemented thoughtfully and consistently. It includes most of the elements of a leading and prevailing practice.

One key aspect of implementation will be to include as many appropriate quantitative metrics as possible to ensure that the goals and expectations are clear and not “fuzzy.” The form does not provide for quantitative goals. The Board may want to consider modifying the form or simply adding a section with appropriate quantitative goals which the Board and the Executive Director agree upon. The Board should also consider delegating the Executive Director evaluation process, including the development of quantitative evaluation metrics, to the Board Governance and Personnel Committee (if adopted).

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**Recommendation 11: CIO Performance Evaluation**

The same process recommendation regarding quantitative goals from Recommendation 10 should apply for the CIO evaluation process. In addition, if SERS chooses to charter an Investment Committee of the Board, we recommend that committee be delegated responsibility for developing quantitative goals and conducting the annual CIO evaluation and that the Investment Committee Chair provide the feedback to the CIO (in lieu of the Personnel Committee and Board Chair, as currently provided). The Executive Director, who is responsible for overall organizational performance, should have significant input into the CIO evaluation process. See also our Recommendation 15.1 re: single vs. dual reporting.

**Recommendation 12: Board Self-Assessment**

The Board should begin with a limited self-assessment process which utilizes criteria established by the Board that best reflect the level of knowledge of fiduciary and governance principles for a SERS Board member. Over time the Board should further develop and implement an annual self-assessment process which assesses the whole board, the chair and assistant chair (assuming that position is created), individual members, committees, and committee chairs and assistant chairs. To facilitate candid comments, the Board should work with its Chief Counsel to identify how public records access requirements relate to self-assessment results and determine the most appropriate process that will assure confidentiality of sensitive information.

The Board could utilize one or more techniques for obtaining self-assessment feedback:

- Engage an expert third party facilitator to lead or co-lead the process with the Chair of the Board Governance and Personnel Committee;
- Get feedback from external key stakeholders on Board performance; and/or,
- Obtain an independent third party evaluation of the Board's performance.

We also recommend obtaining peer-to-peer (360°) feedback from each Board member and upward evaluations from the SERS executive staff who regularly interact with the Board. (Again, 360° feedback is only likely to be useful if the Board can maintain confidentiality of the self-assessment results.) The Self-Assessment could use these competencies as a means to determine its self-development and education priorities. It could also be used to help inform the appointment process in terms of the needs of the Board where gaps may exist. An example board self-assessment framework is attached in Appendix E. A board self-assessment policy will be submitted separately with the draft bylaw changes and policies. (See Recommendation 5; Governance Policy Manual.)

**Recommendation 13: Independent Review**

The Board should require a periodic review of the Board's and SERS' overall effectiveness every three to four years. See Appendix F for example topics to be covered. This should include a fiduciary review of SERS' governance and operations but would be different than a review of investment performance. The Board should also consider input from various stakeholder groups, for example, retirees and active members, legislators, employers, custodian, investment consultants and managers.

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**Recommendation 14: Attendance at Board and Committee Meetings**

Assuming the Board approves the creation of additional committees as proposed, a new bylaw should be established that emphasizes the importance of consistent member attendance at full Board and committee meetings.

In consideration of the significant number of SERS Board members who do not reside in the Harrisburg area and must commute to meetings, SERS should allow telephonic participation for SERS Board and committee meetings. Telephonic participation could be allowed first for committee meetings to assist in developing appropriate processes and procedures. In order to limit the use of teleconferencing to exceptional circumstances, SERS may want to develop guidelines for the Board Chair to consider for approval of each instance of teleconferencing for Board meetings. The Board should also discuss and consider if scheduling meetings when the House and Senate are not in session would better enable participation by the legislative members.

In the future, the Board could consider going further and establish a minimum number of meetings in which a Board member (or the member's designee) is expected to participate annually and the number of times the member (or designee) must physically be in attendance. However, a process for excused absences should be provided in the event of illness or unavoidable scheduling conflicts. The Board could also consider encouraging ex officio and legislative members to appoint designees with relevant skill sets and/or assign responsibility to consistently attend Board and Committee meetings to their designee.

**Recommendation 15.1: Accountability and Operational Risk**

To improve administrative accountability and to reduce operational risk, there should be a single reporting relationship to the Board. If adopted, the Executive Director should become the Chief Executive Officer (CEO). The CIO, while reporting directly to the Executive Director/CEO, would remain responsible and accountable for investments and would still be directly accessible by the Board (see main body of report for more detail). The Investment Committee should have input into the selection and evaluation of the CIO.

**Recommendation 15.2: Evaluation of Service Providers**

Service providers hired to provide advice to the Board should be periodically evaluated by the Board, and the Board should periodically meet with the providers privately in executive session without staff present.

**Recommendation 15.3: Peer Benchmarking**

The Board should consider a benchmarking policy and budget to measure SERS investment and operational performance compared to peers to support continuous improvement and improve independent reinsurance.

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**Recommendation 15.4: Board Education/Strategic Retreat**

The Board education policy included in Recommendation 9 should include a budget for costs associated with new member orientation and continuing education. The Board should also develop an improved orientation program tailored to the specific needs and experience of each new Board member. For Investment Committee members, observing the due diligence process could be included as part of orientation to help familiarize new members with the investment screening process.

Education should be incremental over time to include diverse and independent sources of information including site visits and attendance at conferences.

The Board should hold an annual off-site Board retreat to enable focused discussion on strategic issues. This could be used to develop the preliminary Board and committee agendas for the upcoming year, conduct the annual Board self-assessment, and facilitate more extensive discussion on selected major topics (e.g., asset-liability study, asset allocation or other strategic issues).

**Recommendation 15.5: Board Skills Matrix**

The Board should provide appointing authorities for new members with a copy of the Board member position description and Board skills matrix to encourage selection of appointees with adequate time availability and needed skills.

**Recommendation 15.6: Collaborate with PA PSERS**

SERS should consider additional collaboration opportunities with the Pennsylvania Public School Employees' Retirement System. This could include possible joint meetings to get acquainted, conduct shared benchmarking, education, governance information exchange, and develop a better understanding of each other's perspectives on fulfilling responsibilities.

## Findings, Conclusions and Recommendations

### Board Structure

**1. Evaluate and make recommendations as to the board structure including the need for a vice chairman or other governing board member in the absence or disability of the Chairman.**

**Background:** Although Section 4.1 of the Board's bylaws allows the Board to appoint additional officers and assign them duties, SERS does not currently have a vice chair to fill in during the absence of the chair. SERS Board members expressed support for having an assistant chair in order to have a better process for selecting who should take over leadership in the chair's absence. It appears this typically falls to the Board member with the most seniority.

**Leading and Prevailing Practice:** Over 90% of peer funds boards have a vice chair. This is a prevailing practice which clarifies leadership roles when the chair is absent or indisposed. In many funds where the chair is elected by fellow board members, the vice chair position also serves as a succession planning tool and developmental role to prepare the vice chair to take on the chair role.

While the Governor selects the Board chair pursuant to Section 5091 (a) of the Retirement Code, an assistant chair could both lead meetings when the chair is absent and be assigned other duties to assist the chair with oversight of the Board's responsibilities. For example, at the request of the Chair, the Assistant Chair might also be tasked with presiding over the Board self-assessment, overseeing consideration of potential disciplinary action involving alleged misconduct by the Chair, assisting with development of the agenda, recommending committee membership, or other duties. To provide balanced Board leadership, when the Chair is an elected state official, the Assistant Chair should be selected from the group of Board members who are not elected officials and vice versa. In addition, the Chair and Assistant Chair should, to the extent practicable, not be members or appointees from the same political party.

**Recommendation 1: Board Assistant Chair**

The Board should revise its bylaws to provide for having the SERS Chair, in consultation with the Board, select a Board Assistant Chair to:

- a. Lead the Board when the Chair is absent and also not able to participate telephonically
- b. Assist the Chair in leading the Board and taking on certain duties as specified by the Chair

The proposed duties for a Board Assistant Chair are described in Appendix A. This recommendation will not impact the current appointment of the Chair by the Governor or the duties of the Chair.

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**2. *Evaluate the existing committee structure and make recommendations for additional standing and ad hoc committees as well as the composition of members on those committees, their role and authority.***

**Background:** Nearly all Board and staff members described a lack of clarity concerning which SERS board committees exist today, the scope of their mandates, which Board members are assigned to each committee, and how members are selected to serve on a committee. It was frequently noted in our interviews that a prior chair of the SERS Board had traditionally chaired all committees. This is highly unusual, and there was widespread agreement that it is an outdated practice.

We found general acknowledgement that the Audit Committee is functioning well and that its quarterly meetings are appropriate. The Deferred Compensation and Securities Litigation Committees have recently been meeting, and the Personnel Committee has occasionally met but without any fixed schedule. Other committees were formed and convened in the past to select investment consultants (General Consultant, Real Estate Consultant, and Alternative Investment Consultant committees) but have not recently been active.

The need for a clearly-defined and functioning committee structure is apparent. This was broadly acknowledged by Board members during our interviews, and the SERS staff generally agreed an effective committee structure would be helpful.

Related comments were that most Board members do not have significant interactions with SERS staff, in particular beyond the Executive Director, Chief Investment Officer, Chief Financial Officer, Chief Legal Counsel, and Internal Audit Director. This is not surprising given that, in most peer organizations, much of the board-staff interaction occurs as a result of committee work, not during full board meetings. Many trustees expressed the desire to have more frequent involvement with a broader range of staff.

**Leading and Prevailing Practice:** Boards of state retirement systems typically do most of their work in committees and, on average, have 6-7 committees. One FAS benchmarking study of large public retirement systems indicated that the participants on average spent 43 hours annually in full board meetings and 74 hours in committee meetings (see chart below).

Well-functioning board committees can enhance a board's efficiency and effectiveness. Each committee should have a strategic focus as defined by its charter and must be able to exercise important oversight functions. The committee structure should also be aligned (to the extent practicable) with the staff organization structure to facilitate improved board-staff interaction, greater board familiarity with staff capabilities and better agenda management. It is explicitly intended that use of committees not result in reduced delegation of responsibility and authority to staff. Rather, committees are intended to improve information exchange and development of trust.

Trustees need insight to exercise their oversight and such insight can often be gained in committee deliberations. However, board members need to be cautious to avoid micromanaging and undermining delegated authorities to staff. To avoid the potential to get overly involved with tactical details, it is



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important that the board be familiar with staff due diligence and monitoring processes and comfortable with independent audit reassurance functions.

Among 16 Peer Public Retirement Systems Ranging in Size from \$25 to \$460 billion AUM	No. of Funds with Comm.	% with Comm.	Ave. No. of Mem-bers	Ave. Mtgs./ Year	Ave. Length of Mtg. (Hrs.)	Annual Mtg. Time (Hrs.)
Audit	15	94%	5.9	4.5	2.0	8.8
Investment <u>1/</u>	14	88%	9.1	6.3	4.0	25.4
Performance & Compensation / Personnel	12	75%	5.2	4.0	1.8	7.1
Board Governance <u>2/</u>	8	50%	5.8	3.4	1.9	6.4
Finance / Budget	8	50%	5.3	4.4	1.6	6.8
Shareholder Responsibility / Corporate Governance	7	44%	6.0	4.0	1.8	7.3
Appeal / Disability Review	6	38%	5.0	8.0	1.6	13.0
Pension Benefits / Actuarial	6	38%	7.9	5.3	2.4	12.8
Executive	4	25%	5.0	4.0	3.0	12.0
Policy / External Affairs	4	25%	5.0	3.7	1.2	4.3
Administrative	3	19%	6.0	8.0	1.0	8.0
Legislation	3	19%	5.5	5.5	1.5	8.3
Risk	3	19%	5.7	6.3	2.0	12.7
Health Benefits <u>3/</u>	3	19%	7.8	8.7	2.3	19.5
Other	8	50%	4.9	7.0	1.7	11.9
Total Board			12.9	8.5	5.1	43.1
Total Committees	6.5		5 - 9	3 - 9	1 - 4	74.3

1/ Two smallest funds oversee investments with the whole board

2/ Includes Ethics Committee

3/ Seven funds offer health benefits to members

Note – only one of these funds has a standing Securities Litigation Committee

PA SERS is somewhat unique in not having an Investment Committee of the Board; however, many funds of similar size do consider all investment matters with the full board or have an Investment Committee consisting of the whole board. We, however, advise against a committee of the whole as it would not provide the time and focus which could be expected of a smaller committee. The Investment Committee, which is typically the largest committee of a public fund board, could be comprised of five to seven members.

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In addition to Audit and Personnel/Compensation Committees, which PA SERS has, many peer funds also have committees for Board Governance and Finance & Administration.

Although a committee which solely focuses on Securities Litigation is not common, some peer funds do delegate litigation oversight to a board committee or staff due to the often time-critical nature of litigation activities.

It is prevailing practice for boards to have a standard process for nominating and electing committee chairs and vice chairs that is transparent and well understood. Appendix B describes the proposed duties of the committee Chairs and Assistant Chairs.

The members of each committee of the Board are appointed by the board chair for a specific term (often upon approval of the board), with consideration given to the expressed desires of individual board members, providing participation by each board member or designee on at least one committee, and recognizing the value of periodic rotation of committee members so as to ensure diversity of views and provide members with direct exposure to differing board responsibilities while preserving some level of membership consistency and experience.

Committee charters should be well defined and regularly reviewed and updated.

We are cognizant of the time demands being placed on SERS trustees and have proposed what we believe is the minimal number of committees which can span the appropriate range of topics in order to make the best use of committee member time. We also recommend that each committee be as small as practical, with three to five members each, with the Investment Committee potentially up to seven members, as mentioned earlier. We anticipate that there will be considerable discussion of the various committees and their charters.

### **Recommendation 2: Committees of the Board**

In order to improve overall effectiveness, the Board should:

- a. Revise its bylaws and create a Governance Policy Manual to describe:
  - i. A more formalized committee structure
  - ii. An explicit process for selecting each committee chair and members for a specified term
  - iii. A clear charter for each committee with delegated responsibilities and reporting requirements

The committees should fully analyze and vet recommendations which they would then present to the full Board. Except for authority already delegated to the Securities Litigation Committee, committees would not be empowered to make final decisions for the Board.

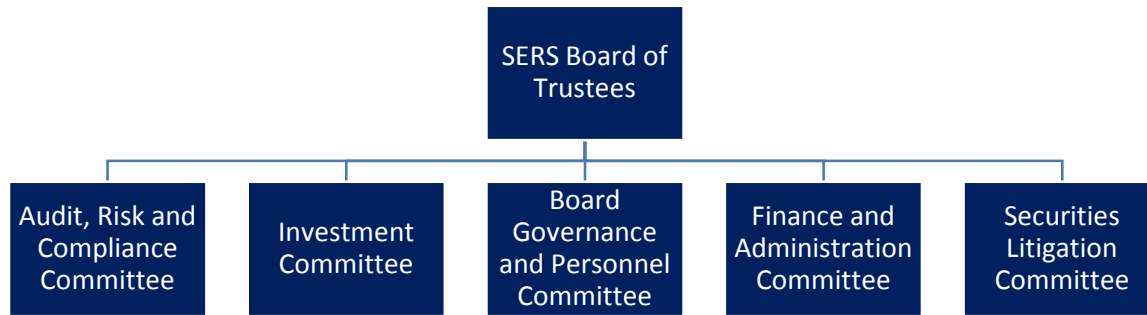
- b. Since the current Audit Committee charter includes oversight of risk management, designate it as the Audit, Risk and Compliance Committee

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- c. In addition to the existing Audit Committee, the Board should create the following new standing committees:
  - i. Investment Committee which could additionally take on corporate governance program oversight and responsibilities of the Deferred Compensation (DC) Committee
  - ii. Board Governance and Personnel Committee
  - iii. Finance and Administration Committee
- d. The Securities Litigation Committee should be formalized as a standing committee which meets on an as needed basis
- e. As a process for selecting each committee chair and committee member:
  - i. With the Board's advice, the Board Chair should appoint Board members (including member designees) to serve on each committee
  - ii. Each committee should elect a chair for a two-year term; with the exception of the Board Governance and Personnel Committee, the Board chair would not be eligible for chairmanship of a committee but could be a member of multiple committees (see Appendix B for a description of the proposed duties of committee Chairs and Assistant Chairs)
  - iii. The Chair of each committee should appoint one of the committee members as Assistant Chair, with the Committee's advice and consent
  - iv. Non-committee members of the Board should be welcome to attend committee meetings as non-voting observers
- f. The charter for each committee should include an odd number of members; with the exception of the Investment Committee, which could have up to seven members, each committee should have a minimum three and a maximum of five, a process for calling meetings and setting agendas, a minimum number of meetings annually (if applicable), responsibilities, and reporting requirements.
- g. The Board should delegate the authority needed by each committee to exercise its responsibilities and make recommendations to the Board.
- h. A process for individual Board members to request pre-meeting assistance in understanding meeting materials could be established to improve committee effectiveness.

Examples of typical responsibilities for each committee are included in Appendix C: Example Committee Charters. The proposed committee structure is shown below:

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**3. Address how committee issues and discussion gets deliberated, are brought to the full board's attention and action, while avoiding a verbatim replay of the committee discussion.**

**Background:** Board members generally said that they would benefit from a more formalized committee structure. Trustees felt committees should perform work which is not currently being conducted by the Board, for example monitoring investment due diligence processes and vetting recommendations from staff. They also expressed frustration with limited time in Board meetings to discuss complex issues and a feeling that many decisions are made based on staff recommendations with minimal Board discussion or debate. The formation of Committees would enable broader trustee engagement in the deliberation process and thus greater confidence in the resulting recommendations.

**Leading and Prevailing Practice:** As mentioned earlier, boards typically accomplish much of their work in committees. Each committee establishes its own agenda, which is shared with the full board in advance. The board collectively has an opportunity to provide feedback to each committee regarding board member interests and concerns. Committee minutes should be distributed to the board, and all board members should be permitted to attend Committee meetings, though voting and official actions would be limited to Committee members.

Each committee meets as frequently as necessary to complete its work. At peer funds, the investment Committee will usually meet the most frequently, typically bi-monthly, for example. Audit, Finance, and Personnel Committees tend to meet quarterly, and Board Governance Committees often meet two to three times per year. The SERS Board will need to determine the appropriate cadence for each committee based upon its responsibilities and annual agenda calendar.

It is the responsibility of each committee member, under the leadership of the committee chair, to fully review and understand the context of the recommendations being considered, due diligence processes, the alternatives available, the pros and cons of each alternative, the risks of action and inaction, and the implementation requirements.

Upon completion of its deliberations, each committee brings its recommendations to the full board with an executive summary and supporting details. During the full board meeting, the executive summary is

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presented, and committee members are prepared to answer questions posed by fellow board members, with support from staff and external service providers.

**Recommendation 3: Board and Committee Agendas**

Each committee chair should share the upcoming committee agenda in advance with the full Board during regular Board meetings. The issue calendar for the Board and each committee could be broadly formulated on an annual basis as part of the strategic planning process (see also Recommendation 15.4). The committee chair should also report to the Board on the committee's discussions and deliberations for significant issues. The committee's recommendations should be presented to the full Board to ensure that each Board member is adequately informed. At the same time, each Board member has a responsibility to stay apprised of key issues being addressed by the various committees.

**4. *Evaluate and make recommendations as to the length of term and rotation of committee members.***

**Background:** SERS bylaws do not include any formal policy on the length of term and rotation of committee members. With the exception of the Audit Committee, there does not appear to be any guidance on these topics. The Audit Committee charter provides for a standard term of three years with staggering of terms and a limit of two terms. A former Audit Committee member who has served two terms may be reappointed to the committee after a one-year absence. There is no rotation policy.

**Leading and Prevailing Practice:** Peer funds often do not have an explicit term for committee membership but rather provide general guidelines. For example, the Maryland State Retirement and Pension System, in their Governance Policies, states: "In making committee appointments, the board and the chairman shall consider continuity in committee membership, opportunities for the diversified experience of trustees, and requisite expertise." CalPERS and the Arizona State Retirement System appoint board members to one-year terms on committees, but typically reappoint most members from year-to-year to ensure continuity.

**Recommendation 4: Committee Terms**

The SERS Board should adopt staggered two-year committee terms, consistent with the two-year terms of House members serving on the Board, with the possibility of a member being appointed to two additional consecutive terms on the Investment Committee and one additional consecutive two-year term on all other committees. Committee term limits could be waived in individual cases by the Board chair when determined appropriate for maintaining a suitable level of experienced members on a committee. Additionally, if a Board member's time permits, he or she could serve on more than one

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committee. As a general policy, each Board member should participate as a member of at least one committee.

### Board Policies and Reporting

#### ***5. Evaluate and make recommendations to retention or modification of existing bylaws and committee charters.***

**Background:** It appears that the SERS bylaws have not been updated since 2006. While the bylaws generally appear to be up-to-date for the topics they cover, either the bylaws or Board policies should provide more complete coverage of governance topics, especially committee structure and operations. See 2. above for a discussion of committee charters.

**Leading and Prevailing Practice:** In addition to bylaws, leading and prevailing practice for peer public retirement systems is to collect all significant governance policies in a Governance Policy Manual. This promotes greater clarity, provides a comprehensive training reference and makes identification of governance provisions easier. Although the structure of governance policies depends on numerous factors which can vary among funds, the following are topical areas which might be covered in a leading practice Governance Policy Manual:

1. Organization Mission, Objectives and Beliefs
2. Board Operations Policies
3. Board Standards of Behavior
4. Board Powers and Delegations
5. Funding Policy and Collection of Contributions
6. Policies and Procedures for Independent Reassurance
7. Board Education Policy
8. Board Performance Evaluation Policy
9. Stakeholder Communications Framework and Policy
10. Service Provider Selection Policies
11. Statement of Investment Policy (often a separate document)
12. Actuarial-Related Policies
13. System Planning and Operational Policies

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Examples of more detailed policy areas included in each of the thirteen topical areas listed above are included in Appendix C.

### **Recommendation 5: Governance Policy Manual**

This governance project developed a draft foundational Governance Policy Manual (GPM) with SERS staff and the Audit Committee which includes policies for those areas included in the scope of the RFP, which are a subset of those typically found in a comprehensive GPM. The policies should include requirements that Board Members and Designees report all material contacts with existing or prospective service providers and investment opportunities, avoid substantive communications with known current procurement candidates and provide for development of a single unified strategic planning process that integrates investment and operational functions in one report. Upon completion of this initial version of the SERS GPM, the Board should direct the Executive Director, in consultation with the Chief Counsel, to consider if additional topics should ultimately be covered in the GPM.

The Board should build upon these foundational policies over time as appropriate. Responsibility for recommending approval of and monitoring policy development should be delegated to the Board Governance and Personnel Committee. The Board's policies should be reviewed and updated periodically (e.g., annually or biennially).

The draft foundational Governance Policy Manual and related policies will be submitted separately with draft revised bylaws. (See Recommendation 9; Bylaws and Committee Charters and Recommendation 12; Board Self-Assessment.)

### ***6. Evaluate and recommend policy that addresses trustee communication with external parties.***

**Background:** There is not currently a SERS policy in effect which provides direction or governs Board member communications with external parties on behalf of SERS. Based upon our interviews with Board members and staff, it does not appear that Board members currently play a significant role in communicating with external stakeholders other than fielding requests from constituents.

**Leading and Prevailing Practice:** Leading practice retirement systems have a comprehensive stakeholder relations strategy and plan which includes and articulates the roles board members, as well as staff, should play. The stakeholder relations plan identifies key stakeholder groups and communication and engagement strategies for each one and provides for monitoring progress through surveys and focus groups. In addition, the trustee communication policy identifies Board responsibilities for external communications. Usually, the communications plan also has a crisis communications component.

### **Recommendation 6: Communications Policy**

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The SERS Board should consider a two-way communications policy which addresses stakeholder engagement and communications requirements and responsibilities. The policy should address who can speak on behalf of the Board and the System. For example, there are typically four main points of communication:

- Communications Director (should be primary point of contact)
- Chair (or another Board member designated by the Chair)
- Executive Director
- Chief Investment Officer

Communications skills should be addressed as part of performance evaluation of each spokesperson. (See also Scope of Work 10 and 11 re: Evaluation of the Executive Director and the Chief Investment Officer.)

SERS should also develop a proactive two-way stakeholder communications plan. Such a plan should begin with a definition of what SERS wants to be known and admired for and compared to how various stakeholders (employees, employers, beneficiaries, legislators, taxpayers etc.) actually perceive SERS. One objective of the plan should be to convey information to stakeholders and close any gaps.

### *7. Evaluate and recommend policy regarding the search process for key service providers.*

**Background:** The SERS Board has authority in the Retirement Code to make procurement decisions and utilize processes it deems appropriate for SERS' needs for the procurement of investment advisors and counselors, actuaries, and other professional personnel. However, most other procurements, except for procurement of investment advisors and managers (which is also expressly excluded by the Procurement Code for SERS), follow standard Commonwealth purchasing guidelines and processes, including approval by the Comptroller in the Governor's Office for availability of funds. Continued use of this cumbersome process could result in missed opportunities and exposure to unwanted risks in the event of sudden future market or risk developments.

**Leading and Prevailing Practice:** Given the unique expertise that is often required to source and evaluate specialized services used by pension funds, standard public procurement methodologies are generally ill suited to promote reliability or integrity of the search process. Leading practice for public pension system procurements includes a transparent, objective, competitive bidding process where the vendor requirements and evaluation criteria are clear and well-articulated.

Based upon a FAS benchmarking study conducted with seven state public pension investment boards, Investment services are not subject to standard purchasing policies at any of the seven investment boards in the survey, similar to SERS' policy. Similarly, procurement of investment consultants or other direct investment support services are exempt from standard state purchasing policies at most of the investment boards. However, at most of the investment boards, routine goods and services not related



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to investments are subject to standard state purchasing policies. A summary of responses is shown in the table below.

Which goods/services are subject to standard state purchasing policies and rules? (N=7)	Not subject to State purchasing requirements	Subject to modified State purchasing requirements	Subject to standard State purchasing requirements
Investment services (e.g., investment manager contracts)	4	3	0
Investment consultants	4	2	1
Other direct investment support services (e.g., trading systems, portfolio accounting, risk management)	3	2	2
Routine goods and services (e.g., furniture, computers, non-investment services)	2	1	4
Comments:			
While not specifically subject to state purchasing requirements, we use state purchasing requirements as a guide. Responded: "Subject to modified State purchasing requirements".			

In a streamlined process, depending upon the situation, the short list of vendors may be developed based upon either a formal Request for Proposal process or a staff- or consultant-led search process. The integrity of the process is validated through a post-procurement audit which ensures compliance with established guidelines and policies but does not impede the process.

**Recommendation 7: Procurement Process**

To facilitate timely selection of other key non-professional administrative or technical investment support services and acquisition of key information systems, SERS should develop a modified procurement process. The modified process should allow acceptable transparency and objectivity, improve the ability to evaluate, select and implement new providers and information systems, as needed, and include documentation to allow oversight on a post-purchase audit basis (rather than imposing pre-purchase restrictions).

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**8. Evaluate and recommend board expectations concerning the types and frequency of routine reports it is to receive from various sources.**

**Background:** Board members generally expressed a desire for changes in Board reporting in terms of the presentation of information and improved responsiveness to investment information requests. The sheer volume of materials distributed to Board members for each meeting was mentioned as a challenge by several, particularly those without designees or legislative staff support to help digest a large quantity of information in a short time period. Trustees also expressed concerns that they are only presented with the arguments in support of a recommendation and not necessarily the opposing views or cons. They, like many boards, feel inundated and want greater analysis by staff and consultants that would provide insight into the volume of information. There was strong support for the use of executive summaries.

**Leading and Prevailing Practice:** Based upon FAS benchmarking with U.S. state public pension funds, investment performance reporting to the board is typically done on a quarterly basis for all asset classes. A sizable minority of funds provide monthly reporting, in particular for public asset classes. It is leading practice for a board to articulate the information it wishes to receive and the frequency, as well as work with staff and advisors to get reports in a format that facilitates understanding of key points. Decisions regarding report contents are also affected by a board's delegation of responsibilities and its reliance on both internal assurance and independent audit reassurance.

For example, in the CalPERS Board Policy Manual, a policy regarding the role and powers of the board states, "The Board will define its information requirements, the thresholds or benchmarks that trigger Board attention for each topic, and the frequency of standard reports." The use of defined reporting thresholds, e.g., the minimum level of an aged receivable account which must be reported to the board, is a leading practice which helps ensure the board is not bogged down in unnecessary operating details but is alerted when a significant event occurs or a major risk condition exists.

CalPERS also provides an opportunity for individual board members to schedule a pre-meeting session with appropriate staff or advisors when additional assistance is needed to understand a report. Special information requests from Board members are submitted through the relevant committee chair at CalPERS, though most other funds designate the Executive Director and/or Chief Investment Officer as the initial contact for special requests. This allows better coordination of information flow to all Board members and reduces duplicative demands on staff time.

**Recommendation 8: Reports to the Board / Information for decision-making that provide consistent data sets in reporting and format which will allow for ease in comparison**

Working in collaboration with the SERS executive staff, the Board should streamline the reporting it currently receives. This could include expansion of SERS' online board documents system for use by

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Board members. Each Committee should review current reports pertinent to its area of responsibility with the goal of improving insight for risk intelligent decision-making. The process might include:

- a. Require that executive summaries which provide insight into the issue, the options available and the thought process behind any recommendation for all decision requests to the Board. The same summary format, with consistent formatting for presentation of data, if applicable, should be used by Committees, staff and consultants. The executive summaries could include, for example:
  - i. Issue/ Background
  - ii. Options / Pros and Cons
  - iii. Risks of action / inaction
  - iv. Areas of disagreement between staff and consultants, if applicable
  - v. Recommendation
- b. A biennial “sunset” review of all reports to eliminate reports deemed unnecessary
- c. Simplification or restructuring of reports which are overly complex
- d. Identification of thresholds or triggers for issues (financial, legal, personnel, operational, reputational, etc.) or non-recurring reports that must be brought to the attention of the Board; staff should bring issues first to the corresponding committee chair or the Board Chair, as appropriate, and to the attention of the full Board at its next meeting

A common list of questions to be routinely asked in relation to a recurring decision, e.g., manager selection or budget approval, should be developed. The Executive Director should be designated as the contact for initiating requests for information from staff.

**9. Evaluate and establish policies that ensure actions taken by the board are consistent with applicable laws and fiduciary duties of the board and staff, including gifts, travel, insider trading and code of conduct.**

**Background:** Section 5931 of the State Employees’ Retirement Code Retirement Code, 71 Pa. C.S.A. §§5101 et seq., (the “Retirement Code”), establishes fiduciary duties of the Board and staff. Primary among those duties are the obligations to *“invest and manage the fund for the exclusive benefit of the members of the system”* and *“not profit directly or indirectly from fund investments and disbursements.”* As fiduciaries, they are also required to exercise their duties with *“that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital.”*

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The Board's governance and investment policies, including section 2.9 of the bylaws on voting conflicts, SERS Conflict of Interest Policy for staff, Financial Disclosure Policy (applying the Public Official and Employee Ethics Act and the Governor's Code of Conduct), as well as the standards of conduct applicable to legislators, are central to ensuring that Board member conduct is consistent with applicable laws and fiduciary duties. Audits and external reviews (like this review of the SERS Board and its organizational structure) also help to promote compliance with applicable laws and fiduciary duties.

While these provisions that SERS has in place appear to provide a reasonable framework for ensuring compliance, the multiple sets of ethical codes applicable to various categories of Board members results in unnecessary complexity. SERS would benefit from development of a single ethics policy statement which uniformly applies to all Board members and (to the extent possible) covers the provisions in each of the codes. In addition, related training sessions should be provided for the Board and staff relating to applicable laws, policies and fiduciary duties of the Board and staff, including gifts, travel, insider trading and code of conduct,

**Leading and Prevailing Practice:** Public pension funds generally have a set of policies in place, with related training and compliance programs, that are intended to ensure compliance with fiduciary duties and applicable laws. While adoption of these practices cannot guarantee absolute compliance, the adoption and implementation of policies that reflect peer practices in the context of a fund's particular circumstances can provide a high level of fiduciary duty and legal compliance. The Governance Policy Manual contents outline set forth above in section 5 illustrates a leading practices approach to these issues.

For example, leading practices are to have policies in place which address the following fiduciary duty of loyalty and legal compliance topics:

- Ethics and standards of conduct
- Conflict of interest
- Personal financial disclosure standards
- Gift and travel acceptance limits
- Personal trading policy and compliance
- Board member misconduct
- Confidential information
- Placement agent fees
- SEC "pay to play" rule compliance and reporting
- Board member referral of investment opportunities and service provider candidates

### **Recommendation 9: Bylaws and Committee Charters**

The Executive Director should coordinate with the Chief Counsel and work with the Board Governance and Personnel Committee to update the bylaws and committee charters and develop policies and reporting mechanisms in accordance with fiduciary and legal compliance principles. Related training

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during the onboarding process for new Trustees, along with regular refresher sessions, should be provided. Board training should be coordinated with Board self-assessment and skills development processes and should include familiarization with the SERS Governance Policy Manual. Relevant training obtained through other sources could be recognized in any training mandate. Periodic reviews and updates of policies, as well as strong audit and compliance programs, are important aspects of independent reassurance and pension fund governance as robust policy statements are only useful if implemented.

Draft bylaw changes will be submitted separately with the draft Governance Policy Manual and policies. (See Recommendation 5: Governance Policy Manual.)

### Performance Evaluation

#### *10. Review the process by which the Executive Director will be evaluated.*

**Background:** Until recently, SERS has not had a formalized review process for the Executive Director or the Chief Investment Officer. However, the SERS Personnel Committee developed a formal Performance Review Process for each position which was presented to and approved by the SERS Board in July 2015. The new annual review process is intended to be conducted on a calendar year basis; 2016 will be the first year the new process will be in effect.

The new SERS evaluation process includes five management competency factors in a standard evaluation form (leadership; planning; management; interpersonal relations; and results) with a five-point rating scale ranging from Far Exceeds Expectations to Unsatisfactory. The Executive Director receives a rating in each of the five factors as well as an overall rating and a summary of strengths and a summary of opportunities for development. The approved new process suggests that, at the discretion of the Board Chair, feedback from the Executive Director's direct reports be solicited as input.

The annual cycle is designed to begin with a development of performance expectations by the SERS Board chair and the Personnel Committee which are then discussed with the Executive Director. As the rating cycle begins in January, these expectations are communicated to the Executive Director and agreed upon.

In June, the Executive Director is expected to provide a mid-year report to the Board Chairman and the Personnel Committee regarding status relative to expectations, and any performance issues are to be addressed with the Board Chair. At calendar yearend, the Board Chair solicits feedback from Board members and SERS executive staff using the standard evaluation form. The Board Chair consolidates all input and provides a summary form to the Personnel Committee and the Committee provides feedback to the Chair. There is an escalation process with the full Board if the Chair and Personnel Committee cannot agree. The Chair provides the completed form to the Executive Director and reviews the results.

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**Leading and Prevailing Practice:** Similar to the new SERS process, leading and prevailing practice at peer state retirement systems is to have a formal annual process for evaluating the performance of the Executive Director with defined performance metrics. The basis for evaluation is typically a combination of quantitative metrics as well as qualitative factors. For the Executive Director, the quantitative metrics are usually linked to achievement of goals defined in the long-range strategic plan and the annual business plan for the organization. If the system has a performance compensation plan for its executives, as many do, the evaluation process will define the basis for the performance award and definition of yearend ratings.

The Personnel Committee typically takes the lead in the evaluation process, soliciting input from fellow board members and the executive staff. Either the Chair of the Personnel Committee or the Board Chair are typically responsible for providing feedback to the Executive Director and discussing overall performance.

In addition to a formal annual process, leading and prevailing practice for the Executive Director evaluation also includes a mid-year feedback process. This helps ensure that the board and executive director identify any performance concerns on a timely basis and take corrective action and minimizes the likelihood of significant surprises in the yearend evaluation.

### **Recommendation 10: Executive Director Performance Evaluation**

The new Executive Director evaluation process adopted by the SERS Board appears to be a sound approach which should be effective if implemented thoughtfully and consistently. It includes most of the elements of a leading and prevailing practice.

One key aspect of implementation will be to include as many appropriate quantitative metrics as possible to ensure that the goals and expectations are clear and not “fuzzy.” The form does not provide for quantitative goals. The Board may want to consider modifying the form or simply adding a section with appropriate quantitative goals which the Board and the Executive Director agree upon. The Board should also consider delegating the Executive Director evaluation process, including the development of quantitative evaluation metrics, to the Board Governance and Personnel Committee (if adopted).

### ***11. Review the process by which the Chief Investment Officer will be evaluated.***

**Background:** The SERS Board has adopted a new evaluation process for the Chief Investment Officer which uses an identical form with the same five management competency factor structure and rating system and the same annual review cycle and process with the Board.

**Leading and Prevailing Practice:** Leading and prevailing practice at peer integrated state retirement systems is for the Chief Investment Officer to report to the Executive Director. Consequently, the

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evaluation process is often executed differently and the Executive Director has primary or secondary responsibility for the process.

In some situations, the Executive Director is responsible for consolidating input from the board, the Investment Staff, and other executive staff with whom the CIO regularly interacts and for providing feedback to the CIO, with the board's input. In other situations, the board retains responsibility for most aspects of the CIO evaluation process with significant input from the Executive Director. In this situation, the Investment Committee of the board, rather than the Personnel Committee, typically is responsible for conducting the process.

**Recommendation 11: CIO Performance Evaluation**

The same process recommendation regarding quantitative goals from Recommendation 10 should apply for the CIO evaluation process. In addition, if SERS chooses to charter an Investment Committee of the Board, we recommend that committee be delegated responsibility for developing quantitative goals and conducting the annual CIO evaluation and that the Investment Committee Chair provide the feedback to the CIO (in lieu of the Personnel Committee and Board Chair, as currently provided). The Executive Director, who is responsible for overall organizational performance, should have significant input into the CIO evaluation process. See also our Recommendation 15.1 re: single vs. dual reporting.

***12. Establish a process whereby the trustees may conduct self-analysis to ensure continuous improvement of the board's effectiveness.***

**Background:** The SERS Board has not conducted a regular, recurring self-assessment process. Trustees expressed considerable interest in understanding how other public retirement systems operate and leading and prevailing practices. This also includes the use of benchmark information. SERS did use a third party benchmarking service for the benefits operations area but this was discontinued for budgetary reasons despite its utility. Trustees assume fiduciary responsibilities in their first meeting, but the learning curve for new board members is often steep. A number of trustees expressed a desire for an improved orientation and onboarding process for new board members tailored to their specific needs and experience.

**Leading and Prevailing Practice:** In leading practice peer retirement systems, a board conducts regular, typically annual, self-assessments of:

- The board as a whole;
- Each committee; and,
- Each individual board member.

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In addition, upward evaluation from executive staff and peer-to-peer evaluations (360°) are utilized. An external facilitator leads the self-assessment process with a combination of questionnaires and interviews. Individualized feedback and personal improvement goals are provided to each board member. The assessment process, but not the results, are publicly disclosed. Results can be used to inform selection of future Board training topics. Many peers utilize an annual off-site board retreat as the venue to complete this process.

The most complete approach for a self-assessment is one that incorporates process, results and an outside perspective. Process issues are helpful to understanding the levers that can increase performance. Results can be aimed at understanding if the board is meeting its fiduciary responsibilities, but are more valuable if they are focused on measuring performance goals that are designed to increase value to the beneficiaries. The outside perspective is important to judge how actual results are being perceived by stakeholders.

### **Recommendation 12: Board Self-Assessment**

The Board should begin with a limited self-assessment process which utilizes criteria established by the Board that best reflect the level of knowledge of fiduciary and governance principles for a SERS Board member. Over time the Board should further develop and implement an annual self-assessment process which assesses the whole board, the chair and assistant chair (assuming that position is created), individual members, committees, and committee chairs and assistant chairs. To facilitate candid comments, the Board should work with its Chief Counsel to identify how public records access requirements relate to self-assessment results and determine the most appropriate process that will assure confidentiality of sensitive information.

The Board could utilize one or more techniques for obtaining self-assessment feedback:

- Engage an expert third party facilitator to lead or co-lead the process with the Chair of the Board Governance and Personnel Committee;
- Get feedback from external key stakeholders on Board performance; and/or,
- Obtain an independent third party evaluation of the Board's performance.

We also recommend obtaining peer-to-peer (360°) feedback from each Board member and upward evaluations from the SERS executive staff who regularly interact with the Board. (Again, 360° feedback is only likely to be useful if the Board can maintain confidentiality of the self-assessment results.) The Self-Assessment could use these competencies as a means to determine its self-development and education priorities. It could also be used to help inform the appointment process in terms of the needs of the Board where gaps may exist. An example board self-assessment framework is attached in Appendix E. A board self-assessment policy will be submitted separately with the draft bylaw changes and policies. (See Recommendation 5; Governance Policy Manual.)



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**13. Consider the need for a periodic, independent evaluation and/or assessment of its performance.**

**Background:** Periodically, SERS has had reviews of its performance by external parties. The most recent independent fiduciary performance review was conducted on behalf of the Department of the Auditor General by IFS in 2006. There is no ongoing requirement for reviews of this type.

**Leading and Prevailing Practice:** Increasingly, state legislatures are requiring independent reviews of state retirement systems on a periodic basis to reassure stakeholders. For example, the New York State Comptroller, the sole fiduciary for the New York State Common Retirement Fund, must commission a fiduciary and conflict of interest review every three years. In South Carolina, the State Inspector General is required to commission a fiduciary performance audit of both the Retirement System Investment Commission and the Public Employee Benefit Authority every three years.

The boards of many other state retirement systems are voluntarily having independent evaluators assess their performance. The CalPERS Board Governance Policy states “An independent third party will assess Board performance every two years.” Based upon FAS’ experience, leading practice is to use a third party to assess board performance every two to four years. This demonstrates a willingness by a board to hold itself publicly accountable in the absence of other oversight.

**Recommendation 13: Independent Review**

The Board should require a periodic review of the Board’s and SERS’ overall effectiveness every three to four years. See Appendix F for example topics to be covered. This should include a fiduciary review of SERS’ governance and operations that would be different than a review of investment performance. The Board should also consider input from various stakeholder groups, for example, retirees and active members, legislators, employers, custodian, investment consultants and managers.

**14. Consider the issue and make recommendations regarding a minimum requirement of each trustee’s attendance at board meetings and key board committee meetings, absent extraordinary circumstances.**

**Background:** Board members interviewed by the FAS team did not indicate there is a general problem with Board member attendance and participation at meetings; however, more than one of the members rarely attends meetings and instead sends a designee as allowed by the bylaws. The Board’s bylaws allow designees to vote on behalf of the ex officio or legislative member who has appointed them. Designees are also counted in determining whether a quorum is present.

Section 1.4 of the bylaws confers the same rights, duties and obligations to designees as the member on whose behalf they are acting. Nevertheless, several Board members expressed concerns regarding the

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desirability of designees attending the SERS Board meetings and voting instead of the primary member; development of a better understanding of the role contemplated by the bylaws for designees would potentially be helpful in resolving some concerns about attendance of the primary member.

Assuming the SERS Board adopts the recommendation to create additional committees, the time commitment required of Board members will increase and managing consistent attendance could potentially become a greater challenge for some members, particularly those who do not reside in the vicinity of Harrisburg or have designees.

We were told that it is not an accepted practice for Board members to participate telephonically at meetings and that if they cannot physically be in Harrisburg, it is not possible to participate in a Board or committee meeting. One member who had missed several meetings this year indicated he could have participated by telephone for at least one of the meetings but the travel time to Harrisburg precluded him from being on-site.

However, it appears that the Pennsylvania Supreme Court has authorized member participation in a public board meeting by teleconference phone or video conference, with remote members counting towards a quorum. See *Babac v. Penn. Milk Marketing Bd.*, 613 A.2d 551 (Pa. 1992).

**Leading and Prevailing Practice:** Many state retirement systems have an explicit policy concerning board member attendance at board and committee meetings. For example, the Maryland State Retirement and Pension System includes the following in their Governance Policies:

- Each trustee shall attend at least 80% of the regularly scheduled board meetings. An excused absence may be granted by any officer of the board for illness, family emergency, jury duty, or attendance at investment or fiduciary training, and such absence shall not be considered an absence for purposes of meeting this requirement.
- If a trustee is unable to attend a meeting of the board or a committee, the trustee shall notify the executive director as soon as possible to help ensure that a quorum will be achieved.
- If personal attendance is impractical, a trustee may attend board or committee meetings via telecommunications.

The CalPERS Board Governance Policy states: "Each Board member or authorized deputy should attend every meeting of the Board, and every meeting of a committee of which s/he is a member. Periodic absences for illness or other non-avoidable personal and professional reasons are expected, however it is also expected that every Board member will achieve at least a 75% attendance standard."

Peer retirement systems which do not have explicit minimum participation targets typically have policies which emphasize the need for board members to commit appropriate time to their role. For example, the Arizona State Retirement System policy states, "Trustees must be willing and able to devote the necessary time to fulfill their duties on the Board."

The Indiana Public Retirement System (INPRS) Board Governance Manual states: "Participation in board meetings is considered to be an essential element of a Board member's fiduciary duty. Therefore,

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members are expected to attend and participate in all meetings unless there are extenuating circumstances that prevent such attendance.”

The INPRS policy goes on to define the acceptance of telephonic participation: “It is hereby the policy of the Board to allow participation by electronic communication. Under IC 5-14-1.5-3.6, at least three (3) trustees must be physically present; all votes during the electronic meeting must be taken by roll call vote; and each trustee is required to physically attend at least one meeting annually.” It should be noted that the INPRS Board has nine members, is required to hold meetings quarterly and typically meets bi-monthly as practice, similar to SERS.

The Washington State Investment Board (WSIB) has adopted a policy on teleconferencing for Board meetings which states:

“Teleconferencing to the Board or its Committee meetings is permitted only upon advance approval by the Chair of the Board or Chair of the particular Committee involved. For Board meetings, in the absence of the Chair, the Vice Chair may grant such approval. For a Committee, in the absence of its Chair, the Chair may designate an acting Chair who may grant such approval. The considerations to be used by the Chair(s) to determine if teleconferencing is appropriate include:

- a. Emergency situations, such as inclement weather, or a meeting of the Board (or one of its Committees) which is called outside of its usual and customarily scheduled time.
- b. Necessity of a quorum in the event presentation of a business item cannot be postponed to a later meeting.
- c. The Chair’s opinion that it is clearly to the advantage of the Board (or its Committee) to allow a teleconference.”

The legislation for SERS, which provides that the appointed designees of SERS ex officio and legislative members can fully participate in Board deliberations and actions on behalf of their member, is prevailing practice for funds with ex officio and appointed state official members. Those members who are not able to regularly attend Board meetings have their designee consistently participate on their behalf.

FAS has not worked with a state retirement system which does not allow members to participate in Board and committee meetings via telephone. In general, it is considered more desirable to have consistent member (or designee) participation, even if it means telephonically, than to prohibit participation by a member who cannot physically be on-site.

**Recommendation 14: Attendance at Board and Committee Meetings**

Assuming the Board approves the creation of additional committees as proposed, a new bylaw should be established that emphasizes the importance of consistent member attendance at full Board and committee meetings.

In consideration of the significant number of SERS Board members who do not reside in the Harrisburg area and must commute to meetings, SERS should allow telephonic participation for SERS Board and committee meetings. Telephonic participation could be allowed first for committee meetings to assist in developing appropriate processes and procedures. In order to limit the use of teleconferencing to

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exceptional circumstances, SERS may want to develop guidelines for the Board Chair to consider for approval of each instance of teleconferencing for Board meetings. The Board should also discuss and consider if scheduling meetings when the House and Senate are not in session would better enable participation by the legislative members.

In the future, the Board could consider going further and establish a minimum number of meetings in which a Board member (or the member's designee) is expected to participate annually and the number of times the member (or designee) must physically be in attendance. However, a process for excused absences should be provided in the event of illness or unavoidable scheduling conflicts. The Board could also consider encouraging ex officio and legislative members to appoint designees with relevant skill sets and/or assign responsibility to consistently attend Board and Committee meetings to their designee.

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Other Recommendations

**15. Additional recommendations to policy as identified by the Contractor as deemed necessary and as approved by SERS Audit Committee.**

Based upon our experience working with peer retirement systems, we have a number of observations and recommendations we suggest the Board consider in addition to the specific recommendations described above:

*15.1. Accountability and Operational Risk*

**Background:** SERS' current structure may cause confusion regarding authority and accountability for administrative decisions between the Executive Director and CIO.

**Leading and Prevailing Practice:** SERS is not the only state retirement system in the U.S. where the Executive Director and Chief Investment Officer both report directly to the Board, but this is the case in less than 20 percent of the larger integrated funds. Of the 43 largest U.S. public retirement systems with an integrated structure similar to SERS, 37 have adopted an organizational model with the Executive Director as the single operating report to the Board. FAS considers dual operational reports to the Board a lagging practice as it diffuses accountability, may contribute to operational risk where investment staffing and infrastructure fail to keep pace and be integrated with the investment strategy, and can require the Board Chair to arbitrate conflicts. Having a single direct operating report to the Board could improve executive accountability and clarity of roles and provide a single point of coordination for Board requests, resulting in more effective and efficient Board and executive decision making.

The CEO can also be a buffer between the Board and investment staff, helping reduce any appearance of undue influence by the Board. We also believe that the single Executive Director reporting structure is a prevailing peer practice because accountability and coordination are clear with one executive as leader of the staff.

We suggest that the SERS Board consider consolidating operational authority under the Executive Director (Internal Audit should continue to report to the Board Audit Committee to provide independent reassurance). Although we recommend this change in the near future, if the Board is not ready to take the action immediately, it could consider such a transition the next time a new Executive Director or Chief Investment Officer is hired. The principal duties of the CEO/Executive Director would include:

1. Lead the organization
2. Support the Board
3. Manage stakeholder relations
4. Manage finances and oversee operations
5. Support the CIO

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The CIO would remain responsible for the investment portfolio and for the supervision and evaluation of investment staff. The Board would still have access to the CIO and any other executive on a regular basis and could retain authority for certain aspects of the CIO hiring, evaluation, compensation and termination process jointly with the Executive Director. Responsibility for negotiating and executing investment transactions would remain delegated from the Executive Director to the CIO. The Executive Director would remain responsible for directing the administration of all units and functions within the system.

**Recommendation 15.1: Accountability and Operational Risk**

To improve administrative accountability and to reduce operational risk, there should be a single reporting relationship to the Board. If adopted, the Executive Director should become the Chief Executive Officer (CEO). The CIO, while reporting directly to the Executive Director/CEO, would remain responsible and accountable for investments and would still be directly accessible by the Board (see main body of report for more detail). The Investment Committee should have input into the selection and evaluation of the CIO.

*15.2. Evaluation of Service Providers*

**Background:** Although consultants selected by the Board to provide services to SERS (such as the actuary, independent auditor and investment advisors) typically work with staff on a day-to-day basis, they report to the Board and should be responsive to the needs of the Board and its committees. In addition to providing advice, these firms provide a very important source of independent reassurance to the Board that the information they are being provided by staff is reliable and can be trusted.

**Leading and Prevailing Practice:** Leading practice in a public retirement system is for the Board, or the appropriate Board committee, to periodically meet in executive session without staff present, and also to evaluate each consultant annually and provide direction for the Board's priorities for the upcoming year.

**Recommendation 15.2: Evaluation of Service Providers**

Service providers hired to provide advice to the Board should be periodically evaluated by the Board, and the Board should periodically meet with the providers privately in executive session without staff present.

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### *15.3. Peer Benchmarking*

**Background:** During our interviews with Board members, we often heard a desire for a perspective on how SERS structure, policies or practices compare to peer state public retirement systems and what would be considered “best practices.”

We were told that, until several years ago, SERS participated in the annual CEM Benchmarking pension administration benchmarking study, that it was very helpful in identifying improvement opportunities, and that SERS saw its costs decline year-over-year as a result. However, the service was discontinued due to budget cuts.

**Leading and Prevailing Practice:** It is a leading practice for a retirement system to have multiple sources of information to advise the board and staff on how their system compares and emerging trends. This also provides another source of independent reassurance to the Board.

Sources of external benchmarking information for SERS to consider could include:

- Visits to other public retirement systems as well as conferences as part of Board and staff continuing education.
- Engagement of a third party to provide periodic benchmarking of investment and/or benefits functions against peers.

Retirement system areas which are often benchmarked by outside parties to provide greater insight, assist in decision-making, and identify areas for improvement include:

- Asset allocation, investment performance and investment management costs
- Pension administration and operations costs and service levels
- Staff compensation structure and levels

### **Recommendation 15.3: Peer Benchmarking**

The Board should consider a benchmarking policy and budget to measure SERS investment and operational performance compared to peers to support continuous improvement and improve independent reassurance.

### *15.4. Board Education/Strategic Retreat*

**Background:** During our interviews with Board members, we heard a consistent desire for more educational opportunities, but also a concern about finding enough time available to receive education. There appears to be consistent support for an annual retreat as a venue for Board training.

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**Leading and Prevailing Practice:** It is prevailing practice for state retirement system boards to have an annual retreat. Typically, the retreat is conducted at an off-site location and includes recurring annual activities such as the Board self-assessment, education sessions provided by third parties, and/or other agenda items which lend themselves to a more extended board session.

It is leading practice for a board to define its minimum continuing education requirements to include ethics, fiduciary responsibility, investments, pensions, and governance. The overall board education program includes a continuing education plan and budget for the entire board and for each member, as well as a program for new members linked to the board self-assessment and identified gaps.

**Recommendation 15.4: Board Education/Strategic Retreat**

The Board education policy included in Recommendation 9 should include a budget for costs associated with new member orientation and continuing education. The Board should also develop an improved orientation program tailored to the specific needs and experience of each new Board member. For Investment Committee members, observing the due diligence process could be included as part of orientation to help familiarize new members with the investment screening process.

Education should be incremental over time to include diverse and independent sources of information including site visits and attendance at conferences.

The Board should hold an annual off-site Board retreat to enable focused discussion on strategic issues. This could be used to develop the preliminary Board and committee agendas for the upcoming year, conduct the annual Board self-assessment, and facilitate more extensive discussion on selected major topics (e.g., asset-liability study, asset allocation or other strategic issues).

*15.5. Board Skills Matrix*

**Background:** A Board such as SERS has limited opportunities to round out its capabilities and experience because it cannot select its new members.

**Leading and Prevailing Practice:** Most similar boards have robust ongoing education programs to try to assist members in developing expertise in additional areas.

An additional option could be for the SERS Board to advise its appointing authorities of the ideal types of skills and experiences which would be most valuable to the Board in prospective new members. While the final decision on appointments will still rest with others, it may be possible for SERS to convince the appointers to focus on experience and credentials in particular areas of benefit to the Board.



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**Recommendation 15.5: Board Skills Matrix**

The Board should provide appointing authorities for new members with a copy of the Board member position description and Board skills matrix to encourage selection of appointees with adequate time availability and needed skills.

*15.6. Collaborate with PA PSERS*

**Background:** We understand that a limited degree of cooperation exists today with the Pennsylvania Public School Employees' Retirement System (PA PSERS) with securities litigation through the Governor's Office of the General Counsel.

**Leading and Prevailing Practice:** We have seen in other states that cooperation can be effective in other areas also.

For example, as the SERS Board develops its education program, it may be possible for SERS and PSERS to work with a local university to develop some common, shared educational classes. It may also be possible to extend the cooperation on securities litigation to develop a shared corporate governance policy and leverage resources to more efficiently implement a corporate governance and sustainable investment practices program.

**Recommendation 15.6: Collaborate with PA PSERS**

SERS should consider additional collaboration opportunities with the Pennsylvania Public School Employees' Retirement System. This could include possible joint meetings to get acquainted, conduct shared benchmarking, education, governance information exchange, and develop a better understanding of each other's perspectives on fulfilling responsibilities.

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## Appendix A: Board Officers

1. The Governor appoints the Board Chair from among its members; the Chair serves at the pleasure of the Governor.
2. The Chair appoints an Assistant Chair who serves at the pleasure of the Chair, typically for a term of two years.
3. The Board shall appoint a Secretary of the Board who shall also serve as the Executive Director of the Retirement System.
4. The Chair shall preside at all meetings of the board. In the event of a vacancy or the absence of the Chair, the Assistant Chair shall assume the duties of the Chair.
5. In all matters pertaining to Board governance, the Chair shall act in consultation with the Assistant Chair. In addition, the Chair may delegate specific duties to the Assistant Chair to assist in leading the board, at his or her discretion.
6. In the event that a vacancy should occur in the position of Assistant Chair, for any reason, the Chair shall appoint a successor for the balance of the unexpired term at the next regular meeting.

See also Committee Chair and Assistant Chair duties below.

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## Appendix B: Committee Chair / Assistant Chair Duties

The Chair's duties and responsibilities include, but are not limited to, the following:

The Chair (and in the absence of the Chair), the Assistant Chair, shall:

1. In consultation with the Executive Director or other board or committee members, schedule dates, times and location for meetings.
2. Ensure meetings are called and held in accordance with SERS mandate, terms of reference or by-laws.
3. In consultation with the Executive Director, and/or other board or committee members, establish and confirm an agenda for each meeting.
4. Ensure the meeting agenda and relevant documents are circulated to the members of the committee 3-5 days in advance of the meeting.
5. Officiate and conduct meetings.
6. Provide leadership and ensure committee members are aware of their obligations and that the committee complies with its responsibilities.
7. Ensure there is sufficient time during the meeting to fully discuss agenda items.
8. Ensure that discussion on agenda items is on topic, productive and professional.
9. Ensure minutes are complete and accurate, retained, included and reviewed at the next meeting.
10. Chair executive session meetings as required.

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## Appendix C: Example Committee Charters

### 1. Investment Committee:

- Recommend an investment policy for SERS
- Recommend investment risk appetite and strategy
- Recommend investment allocations and benchmark targets
- Recommend specific strategies to achieve the investment goals and objectives of the system (e.g., active vs. passive, internal vs. external)
- Oversee investment controls
- Oversee cost effectiveness of the investment program
- Recommend selection and termination of investment managers
- Recommend selection of investment advisors and consultants
- Oversee long-term investment strategy planning
- In collaboration with the State Treasurer, recommend selection of the custodial bank
- Recommend selection of the Chief Investment Officer
- Oversee performance of the Chief Investment Officer and make termination recommendations to the Board, if appropriate
- Monitor SERS compliance with investment policies
- Monitor investment consultant performance
- Oversee DC governance plan with roles and responsibilities
- Oversee selection of the DC plan administrator
- Recommend DC investment plan offerings and default strategy
- Oversee DC plan fund performance
- Oversee DC plan cost efficiency
- Oversee DC plan communications with members
- Monitor the periodic review of DC investment policies and service providers which it oversees or recommends
- Recommend a shareholder responsibility policy for SERS, including:
  - Corporate governance
  - Proxy voting
  - Securities litigation policies
- Monitor corporate governance developments that may affect the value of the holdings in SERS' portfolio
- Recommend participation by SERS in any shareholder rights initiatives

### 2. Board Governance and Personnel Committee:

- Recommend board committee roles and charters
- Recommend board delegations
- Recommend board development and training
- Recommend the board's stakeholder communications plan
- Oversee board effectiveness and period performance reviews

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- Recommend board governance principles and policies
  - Oversee the board self-assessment process
  - Oversee the periodic review of board governance policies
  - Oversee agency strategic planning process and approve strategic plans
  - Recommend human resource policies
  - Oversee succession planning, attrition and vacancy rates and organizational development
  - Recommend organization performance metrics
  - Recommend organization structure
  - Recommend staff compensation and oversee periodic compensation studies
  - Oversee searches for Executive Director, Chief Investment Officer, and Internal Audit Director
  - Oversee the evaluation and compensation of the Executive Director
  - Oversee diversity compliance
3. Finance and Administration Committee:
- Recommend accounting policies
  - Oversee the business planning process and approve business plans
  - Oversee the budgeting process and approve budgets
  - Oversee financial reporting and approve financial reports
  - Oversee liquidity planning
  - Recommend actuarial assumptions and valuations
  - Recommend actuarial policies and soundness
  - Oversee procurement policies and processes
  - Oversee information technology plans and budgets
  - Oversee overall agency operations and cost effectiveness
4. Audit, Compliance and Risk Committee:
- Oversee actuarial audits
  - Oversee compliance functions
  - Recommend enterprise risk appetite and strategy
  - Recommend the enterprise risk framework and management process
  - Oversee the effectiveness of risk management including risk identification, assessment, mitigation and aggregate reporting
  - Oversee independent reassurance (e.g., internal/external audit, compliance, third parties)
  - Oversee financial and real estate audits
  - Oversee financial controls
  - Oversee business continuity planning
  - Oversee investment program compliance
  - Oversee the evaluation and compensation of the Internal Audit Director
5. Securities Litigation Committee (meet as needed)
- Take appropriate actions regarding class action and other investment lawsuits, including selection and compensation of counsel, approval of settlements and other matters

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## Appendix D: Example of Leading Practice Governance Policy Manual Content<sup>1</sup>

1. Organization Mission, Objectives and Beliefs
  - a. *Governing laws and authorities*
  - b. *Benefit plans, funds managed and services offered*
  - c. *Fiduciary standards and duties*
  - d. *Overall Board responsibilities*
  - e. *Governance principles*
  - f. *Investment limitations (if applicable)*
2. Board Operations Policies
  - a. *Role of the Board Chair, Assistant Chair and Committee chairs and assistant chairs*
  - b. *Committee structure, charters and member selection process*
  - c. *Board and committee meeting schedule and annual calendar of recurring Board agenda topics*
  - d. *Process for calling Board and committee special meetings*
  - e. *Meeting agenda setting process*
  - f. *Board meeting policies and practices, e.g., quorum, voting, attendance, rules of order*
  - g. *Public meeting law, executive session, and trustee communication policies and practices*
  - h. *Board and committee minute policies*
  - i. *Schedule for periodic review and updating of policies*
  - j. *Board member indemnification and provision of legal defense*
  - k. *Public records law overview and public comment policy and procedures*
  - l. *Board role in executive succession planning*
3. Board Standards of Behavior
  - a. *Ethics and standards of conduct policies*
  - b. *Conflict of interest policies*
  - c. *Personal financial disclosure policies and standards*
  - d. *Gift and travel policies*
  - e. *Policy on disciplining Board members for misconduct*
  - f. *Confidential information policy*
  - g. *Policy on placement agent certifications, reporting, fee disclosure and compliance*
  - h. *SEC "pay to play" rule compliance and reporting policy*
  - i. *Policy on referral of investment opportunities and service provider candidates*
  - j. *Inside information and personal trading policy and compliance process*
4. Board Powers and Delegations

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<sup>1</sup> Items contemplated for inclusion in the draft foundational Governance Policy Manual which have been developed as part of this Review are italicized.

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- a. Powers reserved for the full Board
  - b. Policy structure for levels of delegated authority to staff
  - c. *Powers delegated to committees*
  - d. *Board standards / process for participation in goal-setting, evaluation and compensation-setting of Executive Director and any other direct reports*
5. Funding Policy and Collection of Contributions
6. Policies and Procedures for Independent Reassurance
- a. Policy and oversight of internal and external audits
  - b. Compliance function and reporting policy
  - c. *Whistleblower policy and process*
  - d. *Policy on periodic independent fiduciary / governance reviews*
7. Board Education Policy
- a. *Board education topics*
  - b. *Board education requirements and program*
  - c. *New member orientation policy and program*
  - d. *Policy on external education programs, travel and other cost reimbursement, and reporting back to the Board*
8. Board Performance Evaluation Policy
- a. *Self-assessment policy for:*
    - i. *Board as a whole*
    - ii. *Committees*
    - iii. *Officers*
    - iv. *Individual Board members*
  - b. *Self-assessment process and frequency*
  - c. *Self-assessment public disclosure policy*
9. Stakeholder Communications Framework and Policy
- a. Board member communications with SERS staff
  - b. Board member communications with system participants
  - c. Board member contact with the media and other external parties
10. Service Provider Selection Policies
- a. Role of the Board and staff in selection of service providers
  - b. Service provider procurement policies and processes
  - c. Contracting guidelines and policies
11. Statement of Investment Policy (often a separate document)
- a. Investment objectives, philosophy and beliefs
  - b. Investment risk appetite, risk tolerance and risk management policy
  - c. Investment roles and responsibilities
    - i. Board
    - ii. Staff

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- iii. Investment service providers
  - iv. Investment managers
  - v. Investment consultants
  - vi. Investment compliance officer
  - d. Investment guidelines
  - e. Asset allocation strategy and overall fund benchmark
  - f. Asset class strategies and benchmarks
  - g. Implementation policies
    - i. Rebalancing
    - ii. Transition management
    - iii. Trading and brokerage
    - iv. Liquidity and use of cash overlays
    - v. Securities lending
    - vi. Use of derivatives
    - vii. Foreign exchange and currency hedging
    - viii. Use of leverage
    - ix. Soft dollar
  - h. Investment manager selection, due diligence, monitoring and termination processes
  - i. Investment manager watch list policy
  - j. Investment manager reporting requirements
  - k. Investment disclosure policy
  - l. Investment cost effectiveness policy
  - m. Proxy voting policy
  - n. Securities litigation policy
  - o. Emerging managers program policy (if applicable)
  - p. Economically-targeted investment policy (if applicable)
  - q. Environment, Social and Governance (ESG) policies (if applicable)
  - r. *Placement agent policy*
12. Actuarial-Related Policies
- a. *Actuarial audit policies and practices*
  - b. *Actuarial accounting policies*
13. System Planning and Operational Policies
- a. *Strategic planning process*
  - b. Budget development and approval process
  - c. Human resource policy
  - d. Enterprise risk management policy
  - e. Business resumption policy

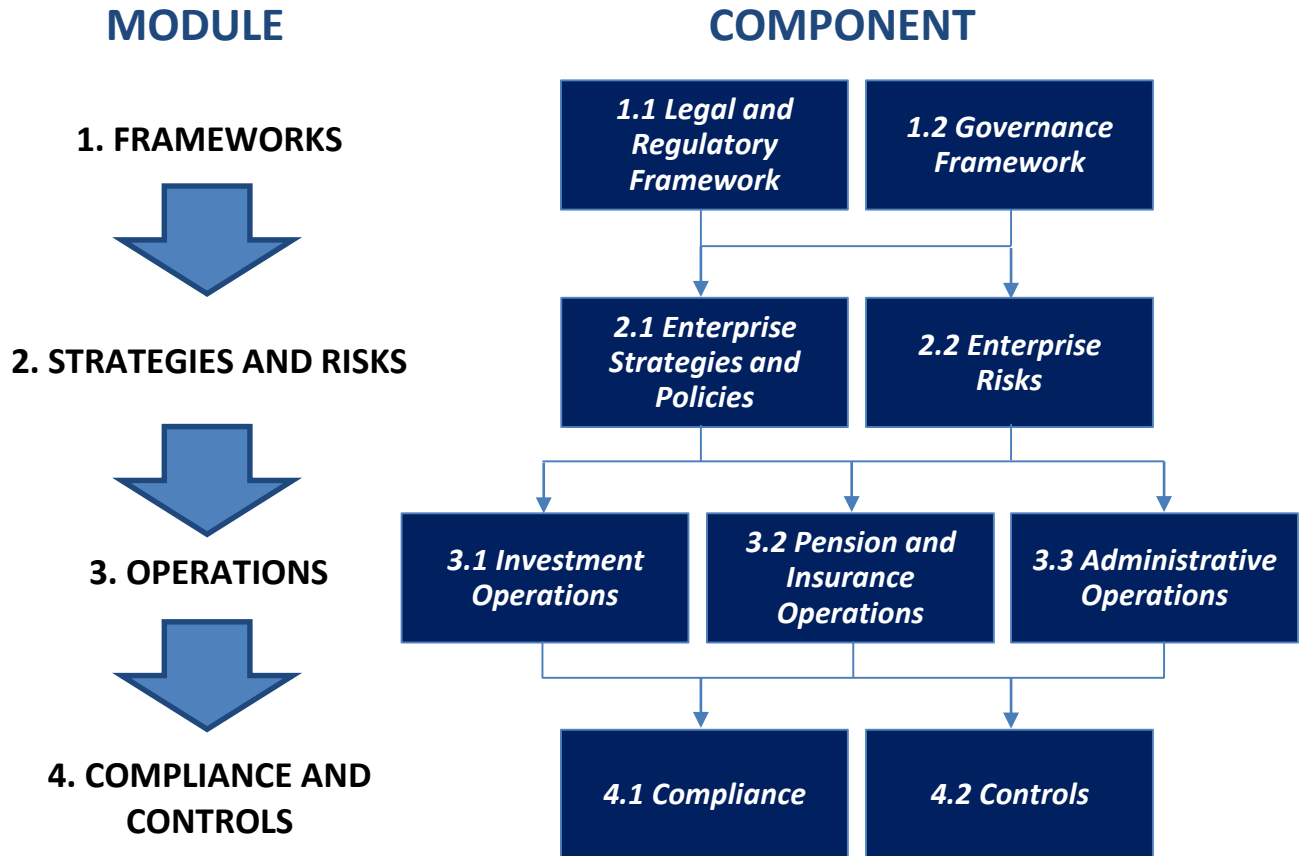


## Appendix E: Example topics for Board Self-Assessment

- Effectiveness and efficiency of Board and committees
- Effectiveness of Board Officers
- Board ethics and standards of conduct / adherence to policies
- Quality of intra-Board and staff dynamics
- Board continuing education and self-development
- Strategic readiness
- Stakeholder engagement
- Enterprise risk management / culture
- Executive oversight
- Investment oversight
- Operations oversight
- Administrative oversight (e.g., HR/succession planning / IT)
- Compliance and control

## Appendix F: Independent Fiduciary Review Topics

### The FAS Fiduciary Review Methodology



#### 1. Frameworks

##### 1.1. Legal and Regulatory Framework e.g.,

- 1.1.1. Governance structure (trustee board, sole fiduciary, other)
- 1.1.2. Funding policies and mechanisms
- 1.1.3. Fiduciary responsibilities and authorities
- 1.1.4. Oversight authorities
- 1.1.5. Statutory authority/limitations
- 1.1.6. Trustee qualifications and selection criteria
- 1.1.7. Investment limitations (prudent expert, prudent person, legal list)
- 1.1.8. Non-economic investment requirements (in-state managers, minority and women-owned programs)

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- 1.1.9. Resource authorities (budget, staffing and compensation)
- 1.1.10. Custodian and selection of custodial bank
- 1.1.11. Selection of external auditor
- 1.1.12. Selection of external actuary
- 1.1.13. Selection of outside counsel
- 1.1.14. Transparency requirements (freedom of information and open meetings laws, contracting, reporting)
- 1.1.15. Trustee indemnification
- 1.1.16. Plan participation requirements
- 1.1.17. Member eligibility and benefit calculation requirements

**1.2. Governance Framework e.g.,**

- 1.2.1. Powers reserved for the board/fiduciary
- 1.2.2. Direct reports to the board/sole fiduciary
- 1.2.3. Delegations to staff and third parties
- 1.2.4. Role of board officers
- 1.2.5. Board committee structure
- 1.2.6. Board and committee charters
- 1.2.7. Use of advisory boards
- 1.2.8. Board/fiduciary focus on strategy
- 1.2.9. Access to information and reporting to the board/fiduciary
- 1.2.10. Board/fiduciary performance
- 1.2.11. Board/fiduciary self-assessment
- 1.2.12. Board/fiduciary self-development
- 1.2.13. Trustee time commitments
- 1.2.14. Management of/response to litigation
- 1.2.15. Enterprise risk oversight
- 1.2.16. Independent reassurance

**2. Strategies and Risks**

**2.1. Enterprise Strategies and Policies e.g.,**

- 2.1.1. Setting asset allocation strategies
- 2.1.2. Setting investment return assumptions
- 2.1.3. Asset-liability matching process
- 2.1.4. Investment beliefs
- 2.1.5. Investment objectives and plans
- 2.1.6. Selection and use of benchmarks
- 2.1.7. Manager fee reporting policies and practices
- 2.1.8. Corporate governance and proxy voting
- 2.1.9. Ethics/conflicts of interest policies
- 2.1.10. Board/fiduciary/employee financial disclosure
- 2.1.11. Employee confidentiality policy
- 2.1.12. Benefit program strategy development

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- 2.1.13. Health care provider strategy development
- 2.1.14. Staff organization structure
- 2.1.15. Organizational and resourcing strategies
- 2.1.16. Staff compensation policies
- 2.1.17. Procurement policies
- 2.1.18. Stakeholder relations and communications
- 2.1.19. Legislative positioning: reactive (awareness of and response to legislative proposals) and proactive (drafting and lobbying)

**2.2. Enterprise Risks e.g.,**

- 2.2.1. Risk appetite/risk tolerance
- 2.2.2. Return and risk objectives
- 2.2.3. Risk management policies and metrics (incl. investment guidelines and limits)
- 2.2.4. Enterprise risk management and reporting

**3. Operations**

**3.1. Investment Operations e.g.,**

- 3.1.1. Investment manager selection / due diligence / monitoring / termination
- 3.1.2. Use and governance of strategic partnerships
- 3.1.3. Roles and authorities of internal investment staff
- 3.1.4. Contracting process
- 3.1.5. Use of outside counsel
- 3.1.6. Internal investment management
- 3.1.7. Investment management reporting, risk, and support systems
- 3.1.8. Investment research
- 3.1.9. Investment cost management
- 3.1.10. Use of general investment consultant
- 3.1.11. Use of specialty consultants
- 3.1.12. Use of custodial services
- 3.1.13. Securities lending policies and practices
- 3.1.14. Foreign exchange practices
- 3.1.15. Use and monitoring of brokers
- 3.1.16. Transition management
- 3.1.17. Investment funding policies and practices

**3.2. Pension and Insurance Operations e.g.,**

- 3.2.1. Member contact center
- 3.2.2. Member self-service opportunities
- 3.2.3. New member enrollment
- 3.2.4. Member data management and data security
- 3.2.5. Member education and communication
- 3.2.6. Member statements
- 3.2.7. Dispute resolution

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- 3.2.8. Adjustments and exception handling
- 3.2.9. Appeals handling
- 3.2.10. Service credit handling
- 3.2.11. Court settlement processing
- 3.2.12. Regular payment processing
- 3.2.13. Pension reporting
- 3.2.14. Pension plan design and development
- 3.2.15. Health care provider contracting
- 3.2.16. Third party provider compliance monitoring
- 3.2.17. Health care cost monitoring and cost controls
- 3.2.18. Employer contact center
- 3.2.19. Employer data management and security
- 3.2.20. Employer education and communication
- 3.2.21. Employer statements and reporting
- 3.2.22. Actuarial reporting practices and valuations

**3.3. Administrative Operations e.g.,**

- 3.3.1. Investment accounting, performance reporting and fund valuation
- 3.3.2. Financial accounting operations and reporting
- 3.3.3. Planning, budgeting and performance reporting
- 3.3.4. Recruitment, hiring and organizational development
- 3.3.5. Employee training and development
- 3.3.6. Succession planning
- 3.3.7. Human resources administration
- 3.3.8. Legal support
- 3.3.9. Information systems planning, governance and support
- 3.3.10. Facilities management and support
- 3.3.11. Procurement
- 3.3.12. Business resumption
- 3.3.13. Policies and procedures documentation and review
- 3.3.14. IT Security

**4. Compliance and Controls**

**4.1. Compliance e.g.,**

- 4.1.1. Internal audit effectiveness
- 4.1.2. Ethics compliance
- 4.1.3. Compliance with laws and regulations
- 4.1.4. Policy compliance
- 4.1.5. Compliance with delegations
- 4.1.6. Board and/or committee operations compliance to charters and policies
- 4.1.7. Contractual compliance
- 4.1.8. Trust and custody compliance
- 4.1.9. Compliance with compensation policies

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- 4.1.10. Compliance with open meeting laws
- 4.1.11. Disclosure and FOIA compliance
- 4.1.12. Compliance with federal statutes and regulations – e.g., OFAC (Office of Foreign Asset Control), NACHA (National Automated Clearing House Association)
- 4.1.13. Compliance with documentation management policies

**4.2. Controls e.g.,**

- 4.2.1. Externally-managed assets
- 4.2.2. Internally-managed portfolio
- 4.2.3. Cash transfers and funding
- 4.2.4. Cash equitization
- 4.2.5. Securities lending
- 4.2.6. Foreign exchange
- 4.2.7. Performance calculations
- 4.2.8. Investment management fee validation