

**Fiduciary Performance Audit
of the South Carolina
Public Employee Benefit Authority**

INVESTING IN PEBA FOR THE FUTURE:
A Transformation Agenda

**January 21, 2015 Presentation to the
South Carolina Senate Special Subcommittee to
Review the Investment of State Retirement Funds**



Project Team Experience

- Dave Stella and Keith Bozarth – formerly Executive Directors of the Wisconsin agencies equivalent to PEBA and RSIC
- Keith Johnson – fiduciary and institutional investor legal expert, former General Counsel for the State of Wisconsin Investment Board
- Rose Hewig – former Deputy General Counsel for New York State Teachers' Retirement System and highly experienced in retirement operations
- Todd McGowan – former banking chief risk and compliance officer and Deloitte audit and IT security partner
- Rick Funston – former leader of Deloitte's Governance and Risk practice and Managing Partner of Funston Advisory Services for five years
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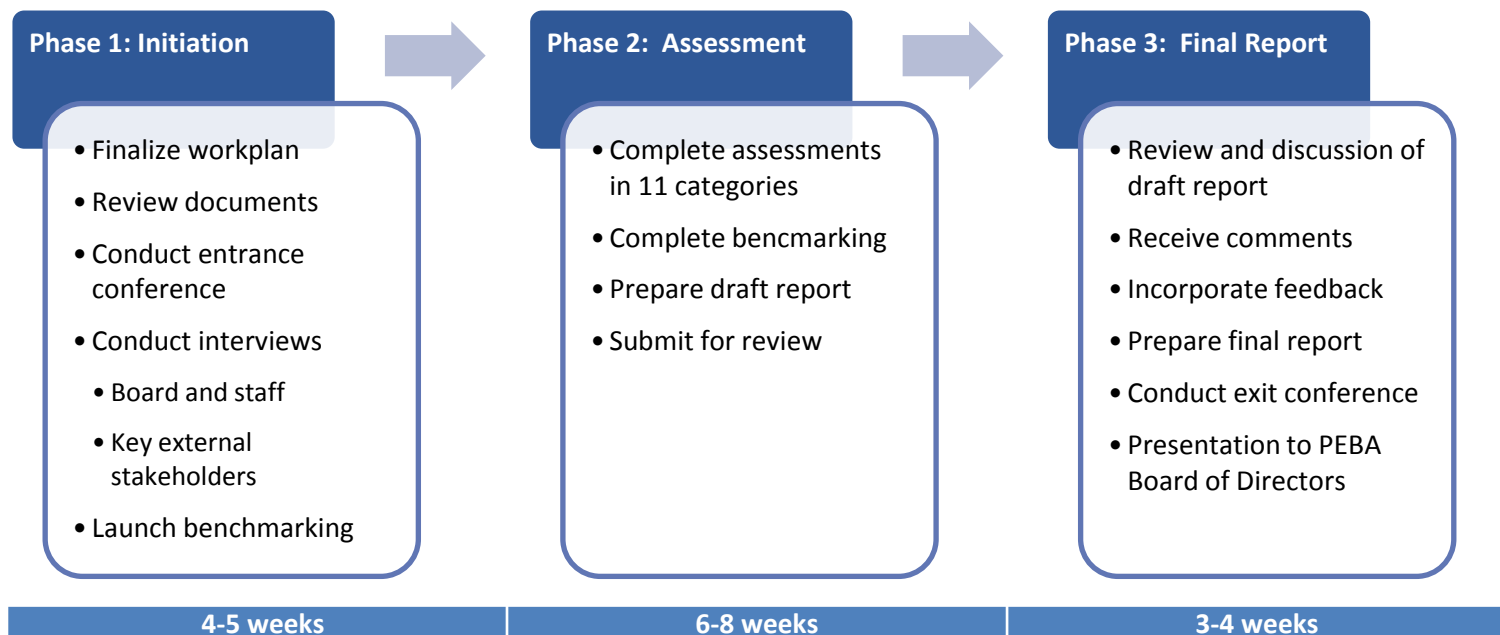
- Fiduciary Performance Audit Purpose, Process and Product
- Overall Conclusions
- Driving the Transformation Agenda
- Legislative Recommendations

Purpose

- Critically evaluate the fiduciary roles and responsibilities of the PEBA Trustees and staff, the relationship with other fiduciaries of the Retirement System, and the operational policies and practices of PEBA.
- The goal of the review was to identify areas of strengths and weaknesses, provide comparison with leading practices of other retirement agencies, and make improvement recommendations.
- Because PEBA is a relatively new state agency, the review was designed to be broad in nature, spanning all key functions, and the review was organized into eleven categories:
 1. Governance
 2. Policy Review and Development
 3. Organization Structure
 4. Communications with Stakeholders
 5. Benefits Administration
 6. Actuarial Matters
 7. Legal Compliance
 8. Customer Service
 9. Record Keeping and Security of Information
 10. Cost of Operations
 11. Information Technology Systems

Process

- The Fiduciary Performance Audit began October 1, 2014.
- We reviewed nearly 400 documents and interviewed over 50 people (several, multiple times).
- We conducted a leading practices benchmarking survey with participation by six other retirement administration agencies.
- Comments and feedback were received from PEBA, STO and RSIC on a Draft Final Report which was submitted on December 22, 2014.
- The Fiduciary Performance Audit Final Report was submitted January 16, 2015.



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Today

Product

- In developing our report, we addressed six fundamental questions:
 1. Who are the South Carolina Retirement System fiduciaries with respect to retirement and insurance administration?
 2. What are their duties?
 3. What are their authorities?
 4. Do their authorities match their duties? Are these duties in conflict with other roles played by the various fiduciaries?
 5. How is PEBA performing?
 6. Where and how can the PEBA improve?
- One hundred thirteen recommendations were identified.
 - 102 can be addressed directly by PEBA, with 40 of these requiring the direct involvement of the Board of Trustees
 - 11 require legislative changes by the General Assembly and three more will require budgetary support from the General Assembly
- The primary purpose of today's presentation is to discuss priorities and implementation considerations that directly involve the General Assembly.

Overall Conclusions

1. PEBA staff are competent, dedicated and service-oriented.
2. The administrative processes used by PEBA to deliver services to members appear to function well and consistently at low cost.
3. However, a transformation is needed for several key reasons and, fortunately, it has already begun.
 - Many processes are not well documented and rely extensively on the institutional knowledge and experience of long-time employees.
 - Up to 45% of employees are eligible for retirement within five years.
 - The ability to adapt to new requirements is limited due to aging information systems and lean staffing.
4. The Board needs to become more strategic and less tactical and delegate more to the Executive Director.
5. The organization should continue to evolve; the recent reorganization is a good step forward.
6. With support from the General Assembly, alignment of fiduciary responsibilities and authorities could be significantly improved.

Driving the Transformation Agenda

- PEBA is only now beginning to achieve a degree of management stability with its first permanent Executive Director in nearly two years.
- Despite budgetary pressures and open staff positions, PEBA staff have done and continue to do an excellent job and morale has remained high.
- There has been minimal investment in PEBA's information systems since its formation in 2012.
- Without investment in people and systems, service quality will likely decline and PEBA will have difficulty adapting to future requirements.
- The recommendations included in this Fiduciary Performance Audit are intended to assist the PEBA Board and staff, as well as provide input to the General Assembly, in formulating the transformation agenda which will help PEBA continue to successfully fulfill its mission.
- We have been pleased with the high level of cooperation, insight and enthusiasm demonstrated by PEBA leadership and believe they can lead a successful transformation with appropriate support by the Board and General Assembly.

Recommendations

- Synthesizing the findings across the eleven categories we reviewed, we organized the recommendations into nine topical areas:
 - Board (19 recommendations)
 - Actuarial (6 recommendations)
 - **Legislation (11 recommendations) – Our focus today**
 - Organization (14 recommendations)
 - Planning (15 recommendations)
 - Policy (7 recommendations)
 - Process (27 recommendations)
 - Risk (8 recommendations)
 - Systems (6 recommendations)
- Specific recommendations are organized by each of these topical areas on the following slides; the most important recommendations in each area are shown in **bold**.

Legislative Recommendations

- **1.1:** The General Assembly should simplify and clarify the system of fiduciary governance for the Retirement System and insurance programs by reducing the multiple conflicts and overlapping fiduciary authority of the Treasurer and BCB (and its successors) with PEBA.
- **1.3.1:** The General Assembly should transfer investment responsibility for insurance trust fund assets to the Retirement System Investment Commission as the most qualified State entity to provide those services.
- **1.3.2:** The General Assembly should transfer approval of Deferred Compensation investment options from the State Treasurer to the PEBA Board of Trustees.
- **1.4:** The General Assembly should allow PEBA greater flexibility to reduce the number of ORP vendors in order to obtain lower fees and make other improvements without materially affecting program quality.

Legislative Recommendations

- **1.6: The General Assembly should update the PEBA Board Member appointment process to be more consistent with peer practices. This should include consideration of four- or five-year staggered terms, subject only to early removal for cause. It might also include consideration of changes in the appointment process to improve engagement with participant groups and the PEBA Board by establishing a process for them to submit qualified candidates for consideration by the appointing authorities.**
- 1.2: The General Assembly should give the PEBA Board of Trustees greater independence for budget and headcount decisions to ensure that they are consistent with the strict fiduciary standards to which it is bound.
- 1.5: The General Assembly should eliminate the requirement for a Retirement and Pre-Retirement Advisory Panel, in the context of an improved PEBA Board communications and engagement plan that covers a broad range of stakeholder groups. See also Recommendation 4.9.
- 4.9: The General Assembly should eliminate the requirement for PEBA to convene a Retirement and Preretirement Advisory Panel, as it duplicates responsibilities of the PEBA Board has not been meeting its legislative intent. See also Recommendation 1.5.
- 1.7: The statutory requirement that the PEBA Board meet monthly throughout the year should be repealed.

Legislative Recommendations

- 4.10: The General Assembly should include a provision in future legislation that replaces references to the BCB, or its successor, in S.C. Code Ann. §§ 9-1-1310 and 9-4-45 with specific references to the SFAA, in order to more explicitly effectuate transfer of the BCB's co-trustee functions to new State Fiscal Accountability Authority.
- 8.10: The General Assembly should eliminate the notarization requirement for a member death by amending the appropriate statutes to delete the requirement for a “duly acknowledged” written notification to PEBA.