

# INVESTING IN PEBA FOR THE FUTURE:

## *A Transformation Agenda*

### *Final Report*

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

January 16, 2015



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January 16, 2015

Mr. Patrick J. Maley, Inspector General  
South Carolina Office of the Inspector General  
The Enoree Building, 111 Executive Center Drive, Suite 204  
Columbia, South Carolina 29210-8416

Dear Mr. Maley:

Please find attached our final report on the Fiduciary Performance Audit of the South Carolina Public Employee Benefit Authority (PEBA). We wish to thank the PEBA Board of Trustees, the Executive Director and staff, the Retirement System Investment Commission (RSIC), the State Treasurer's Office (STO) and the retiree representatives and many others who participated in this review for their cooperation and contributions. A complete list of interviews is contained in Appendix G.

We recognize the timely accumulation and production of numerous documents, interviews and requests for clarification has been very time consuming and we greatly appreciate the timely and thoughtful manner in which all parties have responded. We also wish to thank the Office of the State Inspector General (SIG) for its professionalism and assistance in coordinating this review.

PEBA has accomplished much during its first two years. Its service quality is currently equal to its peers but at half the cost. However, for a variety of reasons, these levels of service and cost will become increasingly difficult to sustain in the foreseeable future. There is enormous complexity and rapid change occurring in public retirement system benefits administration, especially in health care. At the same time, PEBA faces a retirement cliff within its own organization and needs to transform itself to meet the challenges that lie ahead.

The appointment of a new full-time Executive Director in July 2014 was a significant step for the organization. The Executive Director has quickly set the tone for PEBA and has already reshaped the organization and begun the transformation process. Throughout this review, the Funston Advisory Services team was asked for input to PEBA's planned organizational changes.

We provided our initial comprehensive observations and recommendations to PEBA leadership in early December and incorporated their feedback. We then submitted to the Inspector

General a draft final report on December 22, 2014. This draft report was reviewed by PEBA, RSIC and the State Treasurer's Office (STO). We received timely feedback from each party and have attempted to incorporate their feedback into our final findings, conclusions and recommendations. Copies of the responses from RSIC and STO are included as appendices to this report. We have responded separately to the STO's feedback and our response is also included as an Appendix.

We have obtained PEBA's feedback on priorities for implementation of each of our recommendations. Each recommendation is organized by theme, its criticality, the degree of difficulty and whether the Board, the General Assembly or other stakeholders need to be involved.

In total, our final report includes 113 recommendations for improvement. Of these, 102 can be addressed directly by PEBA, with 40 of these requiring the involvement of the Board of Trustees. Eleven of the recommendations require legislative changes by the General Assembly and three will require budgetary support from the General Assembly.

Clearly the executive and staff, the Board and the General Assembly each play an important role in ensuring the provision of benefits and quality of services to the South Carolina public employee system's beneficiaries and participants. We recognize resources are limited and recommendations need to be pragmatic and cost-effective. As a next step, the PEBA Board and executive leadership should agree on priorities and assign the necessary resources for the implementation of those recommendations ranked as critical and important and within their control.

PEBA itself has recognized the need for transformation and we sincerely hope this report can be an effective support to PEBA as it continues to evolve to meet foreseeable future needs.

Very truly yours,



Rick Funston  
Managing Partner  
Funston Advisory Services LLC

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## **Executive Summary**

In September 2014, the South Carolina Office of the State Inspector General (SIG) engaged Funston Advisory Services LLC (FAS) to conduct a fiduciary performance audit of the Public Employee Benefit Authority (PEBA). The purpose of this audit was to:

- Critically evaluate the fiduciary roles and responsibilities of PEBA and staff; the relationship with each other and other fiduciaries of the Retirement System (as defined below); and the operational policies and practices of each.
- Identify areas of strengths and weaknesses, along with improvement recommendations and conformance with best practices of other public pension and employee benefit plans.
- Articulate and prioritize recommendations according to their significance and urgency, and, where feasible, include an analysis of potential costs or benefits associated with implementation.

### **Reasonable Assurance and Independent Reassurance**

It is the responsibility of executive management to provide reasonable assurance to the PEBA Board of Trustees that there are capable people, processes and systems to manage and administer the retirement and insurance operations of PEBA. Third parties independent of management can offer reasonable reassurance that executives' reports are reliable. While no audit can provide an absolute guarantee of compliance or the absence of misconduct, reasonable assurance is still a high standard of assurance.

A fiduciary performance audit is separate and distinct from a forensic investigation, a compliance audit or an audit of the financial statements. Accordingly, we have relied on the reports of others such as CliftonLarsonAllen and Elliott Davis LLC regarding the appropriateness of past practices and the integrity of the financial statements.

### **Process**

Our fiduciary performance audit compared PEBA's current practices with leading practices to understand fiduciary strengths, weaknesses, risks and opportunities for improvement.

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There were three phases to our audit: Initiation, Assessment and Final Report. The review began on October 1, 2014 following the awarding of the contract. We reviewed nearly 400 documents (see *Appendix H: List of Documents Reviewed*) and conducted interviews with over 50 individuals (See *Appendix G: List of Interviews*), including: all eleven Trustees; over twenty PEBA staff; four employer benefit managers; five employee association executive directors; several State Retiree Association board members; the RSIC Executive Director; PEBA's general investment consultant; PEBA's external auditors (CliftonLarsonAllen and Elliott Davis); and the actuary (Gabriel Roeder Smith).

FAS also designed, conducted and analyzed a custom survey with six peer retirement administration agencies (see *Appendix C: FAS Benchmarking Survey of PEBA Peers*). We relied upon the 2013 CEM Pension Administration Benchmarking Report conducted by the independent firm, CEM Benchmarking Inc. (CEM), as part of this fiduciary performance audit for retirement administration cost and customer service analysis (see *Appendix B: 2013 CEM Benchmarking Report Executive Summary*).

FAS submitted Status Reports to the SIG on November 3, 2014 and December 3, 2014 with preliminary conclusions and recommendations. We reviewed these preliminary results with PEBA to obtain their feedback. On December 22, 2014, FAS submitted a Draft Final Report. Written feedback on the Draft Final Report was provided to FAS by January 12, 2015 from PEBA, RSIC and STO. During this time, we continued to respond to questions and comments and complete additional interviews. The written responses of RSIC and STO to the Draft Final Report have been included as Appendices J and K to this report. The FAS response to the STO comments is included as Appendix L. The Final PEBA Fiduciary Performance Audit Report was submitted to the SIG on January 16, 2015. We plan to meet with the PEBA Board of Trustees to make our final presentation in Columbia at their January 21, 2015 regular meeting.

### **The Duties of a Fiduciary**

For this review, we used the fiduciary standard found in the South Carolina Code of Laws, Title 9 - Retirement Systems, Chapter 16, Retirement System Funds, Article 1, Duties of the Trustee, Fiduciaries, Agents. According to SECTION 9-16-40. Standards for discharge of duty. A trustee, commission member, or other fiduciary shall discharge duties with respect to a retirement system:

- 1) solely in the interest of the retirement systems, participants, and beneficiaries;
- 2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;

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- 3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;
- 4) impartially, taking into account any differing interests of participants and beneficiaries;
- 5) incurring only costs that are appropriate and reasonable; and
- 6) in accordance with a good faith interpretation of this chapter.

In developing our report, we addressed six fundamental questions:

- Who are the South Carolina Retirement System fiduciaries with respect to retirement and insurance administration?
- What are their duties?
- What are their authorities?
- Do their authorities match their duties? Are these duties in conflict with other roles played by the various fiduciaries?
- How is PEBA performing?
- Where and how can the PEBA improve?

## **Overarching Themes in our Analysis**

Looking across the eleven areas we reviewed, we identified four overarching themes for our recommendations to PEBA:

- Continue to keep the promise to the beneficiaries
- Clarify the governance structure and empower the Board
- Engage the beneficiaries and the General Assembly
- Transform the organization to prepare for the foreseeable future by:
  - Becoming a more strategic fiduciary board
  - Enabling executive leadership to execute the strategy
  - Focusing on developing the capabilities of PEBA's people, processes and systems
  - Making an investment for the future of the beneficiaries (after all, it's their money)

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### **Background**

#### **The South Carolina Public Employee Benefit Authority (PEBA)**

PEBA was created by the South Carolina General Assembly on July 1, 2012 as an administrative agency of state government responsible for the administration and management of the state's employee insurance programs and retirement systems. Prior to PEBA's creation, the offices of the South Carolina Retirement Systems and the Employee Insurance Program were incorporated within the Office of the State Budget and Control Board (BCB). Each program had established, stable and mature organizations, with capable staffing, processes and systems and to our knowledge delivered high quality services.

Their operations were to be transferred to Department of Administration when it became the successor organization to the BCB. Instead, the change in legislation to create PEBA as a separate entity was advocated by several constituencies, including the retirees themselves.

PEBA and the BCB remain co-trustees of the retirement system trust funds, serving as fiduciary stewards for active members, annuitants, beneficiaries, and plan participants of the following funds and trust funds:

- PEBA Insurance Benefits
- PEBA Retiree Health Insurance Trust Fund
- PEBA Long-Term Disability Insurance Trust Fund
- South Carolina Retirement Systems

As of June 30, 2014, the net position held in trust for Retirement System benefits was approximately \$29.9 billion representing 550,000 active, retired and inactive participants and beneficiaries. The total net position of the combined insurance trust fund assets totaled \$1.054 billion as of June 30, 2014. These funds are the assets of the beneficiaries and are not state assets. The funds to operate PEBA and its sister agency, the Retirement System Investment Commission (RSIC), come from the beneficiaries' assets. In accordance with state statute, operational costs are paid from the funds held in trust.

#### **Benefit Programs and Services**

PEBA administers the various retirement systems and insurance programs of the state. The PEBA Retirement Division is comprised of five governmental defined benefit plans: South Carolina Retirement System; South Carolina Police Officers Retirement System; Retirement System for Judges and Solicitors of the State of South Carolina; Retirement System for Members

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of the General Assembly of the State of South Carolina; and the South Carolina National Guard Supplemental Retirement Plan, collectively referred to hereinafter as the "Retirement System."

The State Optional Retirement Program (State ORP) is an alternative to the South Carolina Retirement System (SCRS) retirement plan. Employees eligible for State ORP participation may choose between the State ORP, which is a defined contribution plan, or the traditional SCRS plan, which is a defined benefit plan.

State ORP is a 401(a) qualified governmental plan that provides an account into which both the employee and the employer contribute. Income at retirement is based upon the account balance accumulated throughout the employee's years of employment. Any distributions, investment gains or losses affect the balance.

The account balance is a combination of contributions, performance of the investment funds selected by the employee, and fees or expenses relating to the investment options offered by the State ORP's investment providers. There are four approved investment providers: TIAA-CREF, MassMutual, MetLife, and VALIC.

The South Carolina Deferred Compensation Program (SCDCP) offers 401(k) and 457 savings plans. These voluntary retirement savings plans help employees supplement their PEBA Retirement Benefits' pension or State ORP savings. If approved by their employer, employees may participate in both of these plans.

Each plan also offers a Roth account option. As of December 31, 2013, the 401(k) plan had approximately 77,160 participants and over \$2.6 billion in plan net assets. The 457 plan had approximately 24,431 participants and \$924 million in net assets. On PEBA's behalf, Empower Retirement (formerly Great-West Financial) is the third-party record-keeper and administrator of both plans.

Significant changes have occurred within PEBA since its inception:

- Appointments to a new 11-member board of directors were completed in October 2012;
- The agency's first strategic plan was approved by the board in the fall of 2012;
- PEBA's management restructured the agency organizationally and began the physical relocation of all employees from two locations to one in October 2012, resulting in all employees being physically relocated to one geographic location by the end of fiscal year 2013;
- Similar functions were consolidated, including Administration, Customer Service Call Center, Visitors Center/Subscriber Services, Field Services, Legal, and Communications;

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- Operational improvements were implemented in the consolidated functions including development of and/or modifications to myriad information systems, strengthened information systems security, added internal and external controls to safeguard data, and a variety of enhanced service delivery processes;
- Staff were reassigned to serve as Board liaisons;
- The PEBA board assumed administrative responsibility for the S.C. Deferred Compensation Program beginning January 1, 2014.

The retirement system assets are invested and managed by the Retirement System Investment Commission (RSIC) and the insurance trust fund assets are invested and managed by the State Treasurer's Office (STO).

PEBA and the BCB are co-trustees of the Retirement Systems Trust Fund. PEBA also serves as trustee for the insurance trust funds, though policy decisions on coverage and premium changes are subject to approval by the BCB.

The State Treasurer is the custodian of the funds of the Retirement Systems and payments from those funds may be made by the Treasurer only upon vouchers signed by two persons designated by PEBA.

However, the Restructuring Act of 2014 abolishes the BCB and creates a new Department of Administration (DOA) and State Fiscal Accountability Authority (SFAA). The BCB's co-trustee responsibilities appear to be transferred by the Act to the SFAA as of July 1, 2015.

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## **OUR CONCLUSIONS AND RECOMMENDATIONS**

The following pages describe a high level summary of our conclusions about PEBA's current state and our recommendations to strengthen it for the foreseeable future.

### **PEBA's Service Promise**

Since its formation, PEBA has been keeping its service promise while maintaining strong cost controls. According to the service metrics collected by PEBA and our interviews, the beneficiaries and employers are very satisfied with the quality and timeliness of the services they receive. Based on more extensive criteria used by CEM Benchmarking, PEBA provides member/pensioner service below the median of its peer group but at the lowest cost per member and annuitant, i.e., less than half the cost of the peer group average.

PEBA has performed well despite some significant challenges. One might ask "If it ain't broke, why fix it?" We believe there is a window of opportunity to fix it before it breaks.

Major challenges are foreseeable on a three to five year horizon and include:

- Complexity in health insurance policy is increasing;
- PEBA's administrative costs are artificially low and unsustainable;
- Much of the historical operational process knowledge resides in the "institutional memory" of staff and is not well documented;
- 45% of current staff become eligible to retire in the next five years;
- Decades-old software systems are inflexible and will not be able to keep pace with needed changes; and,
- Staff proficient in the legacy programming languages are among those retiring and finding replacements will be increasingly difficult.

To continue to keep PEBA's service promise, an organizational transformation is needed. It begins with the legislation and the role of the trustees. It will require strong executive leadership and an investment to maintain and build capable people, processes and systems for the future.

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### **Governance and the Board of Trustees**

Trustees must meet stringent qualification criteria. They serve just two-year terms even though the average learning curve for a trustee or a corporate director is about two years. The complexity of policy issues facing public retirement systems is already high and rapidly increasing.

The trustees serve “at the will” of their political appointers and can be terminated without cause at any time. Trustees should be more independent and serve longer terms to ensure the stability of the Board.

Once appointed, trustees have a primary fiduciary duty of loyalty to the beneficiaries, not their appointers, their constituencies or the taxpayer. Trustees need to develop a common understanding and shared commitment to their fiduciary duties.

There remains fiduciary complexity and ambiguity given the number of fiduciaries and the misalignment of authority and fiduciary responsibilities. The Board should also reexamine its Communication Policy and its approach to engaging its key stakeholders such as beneficiaries and the General Assembly. For the legislature, there are a number of outdated statutes that unnecessarily restrict PEBA’s decision authority.

There are also a number of opportunities to improve the operations of the Board and its committees. There needs to be an increased Board focus on strategic issues and increased oversight of the Audit, Risk and Compliance Functions. There should be a rethinking of board delegation and Powers Reserved for the Board with greater delegation to the Executive Director.

One of the most important and strategic responsibilities of the Board is to recruit, select, evaluate, compensate and, if needed, terminate the Executive Director.

### **The Executive Director**

Since the initial Executive Director resigned soon after the formation of PEBA, there have been two interim Executive Directors in two years. Trustees have become deeply involved in the organization. A permanent Executive Director was appointed in July 2014.

The Board needs to become more strategic and delegate more to the Executive Director. The Executive Director, in turn, needs to be able to delegate more responsibilities. This requires maintaining and building capable people, processes and systems.

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### **People, Processes and Systems**

Based upon our interviews with the PEBA Board and staff, as well as numerous external interviews with employers, member and retiree groups, and third party providers, PEBA staff are competent, dedicated and service-oriented. They provide a consistent level of customer service.

The administrative processes used by PEBA to deliver services to members appear to function well and consistently. However, many processes are not well documented and rely extensively on the knowledge of long-time employees. As up to 45% of employees are eligible for retirement within five years, this retirement cliff presents a significant risk.

Similarly, the PEBA information systems have allowed delivery of quality services to members but the ability to maintain and, especially, to adapt to new requirements, is limited. This has been a barrier to achieving further integration of retirement and insurance operations over the past two years. Over the next three to five years, successful migration to a new information technology platform will be a critical factor for long-term success.

### **Sense of Urgency**

There needs to be a sense of urgency. A transformation takes time and the retirement cliff is just three to five years out. Fortunately, the transformation has already begun. A permanent Executive Director was appointed in July 2014. Priorities are being established and resources assigned. Positions are being filled. The organization has been restructured. Morale is high. Planning for a major systems overhaul is underway. In the course of this review, as we identified improvement opportunities, executives have been highly responsive. Many of our recommendations are already being considered and/or have been adopted.

The following pages expand briefly on this overview.

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**PEBA provides quality service at the lowest cost in its peer group**

According to the most recent CEM Benchmarking study, during fiscal year 2013 PEBA delivered customer service levels below the median of its peer group (68 vs. 76 on a 1-100 scale) but at half the cost of the peer group average. Based upon our interviews and review of customer service metrics, it appears that PEBA's core value of providing "outstanding products, excellent customer service and continuous improvement" is being fulfilled by the PEBA staff, particularly in consideration of the budget limitations.

For example, PEBA Call Center surveys regarding service timeliness, courtesy, and effectiveness, indicate a very high level of overall satisfaction. For FY13 and FY14, the results were:

- Timeliness = 98+%
- Courtesy and respect = 99+%
- Effectiveness = 97+%
- Overall satisfaction = 97+%

Despite an increase in FY12 and FY13, visitor center wait times for retirement and insurance have been reduced to historical lows in FY14. Visitor Center customer satisfaction has remained at over 99% for each of the past ten years and was at 99.58% in FY14.

PEBA's cost of retirement operations is less than half that of its peers. It is the lowest cost operator in its peer group and its costs have declined over 25 percent since 2009 on a per member basis. However, PEBA's lower costs are due to lower per employee compensation and facility costs, the absence of major projects, lack of IT investment and reduced back office support. It is not due to higher levels of productivity; in fact, PEBA's productivity is slightly lower than average for the peer group.

PEBA also has higher administrative complexity than its peers due to factors such as more pension payment options (resulting from PEBA offering defined contribution choices); more complex plan types, benefit formulae, and contribution rates; more complex service credit, purchase and disability rules; and more complex defined contribution plan rules.

**PEBA has done well in keeping its service promise despite some significant challenges.**

These challenges include:

- Delays in appointing a full-time Executive Director that have led to delays in decisions to develop PEBA's capabilities and achieve further integration of retirement and insurance
- Prolonged under-staffing at all levels which has only recently been addressed

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- Lack of investment in information systems
- Complex and rapidly changing health policy issues

PEBA has experienced delays in developing capabilities in people, processes and systems associated with the absence of a permanent Executive Director. Since the initial Executive Director left in November 2012, soon after the formation of PEBA, there have been two interim Executive Directors. The interim Executive Directors appear to have been understandably reluctant to make long-term decisions, commitments and staff appointments that might be contrary to the eventual direction selected by the permanent Executive Director.

This seems to have resulted in maintaining the status quo and keeping costs down. Cost containment is obviously desirable but we doubt the current level of service quality and costs are sustainable. Approved positions were left vacant (at one point 36 positions were vacant) and investments in organization, processes and systems were deferred. An initial focus on cost reduction appears to have become pervasive. PEBA staff have made heroic efforts to deliver excellent products and services.

### **“So if it ain’t broke, why fix it?”**

Within the next five years, PEBA estimates 45% of PEBA staff will be eligible to retire. There are also a number of PEBA staff in the Teachers and Employees Retention Initiative (TERI), which will end in 2018. Clearly maintaining high quality of service has been a key focus for PEBA but process documentation has suffered. While many practices are very good, they are not well described. This makes it difficult to accurately determine what is and is not working. It also makes it difficult to automate and makes the organization vulnerable to dependencies on key personnel who have much of the “institutional memory” in their heads.

There has been minimal investment in PEBA’s information systems since its formation in 2012. Many systems are now written in decades-old languages. There are few remaining staff who are proficient in those legacy languages, their retirement is approaching, and replacements are extremely difficult to find. It is becoming increasingly difficult to make system patches and changes.

Health policy has been rapidly changing as the result of the Affordable Care Act. PEBA has oversight of a variety of insurance programs, including monitoring results and making changes to health plan design to improve outcomes and reduce costs in areas such as: Health insurance (including prescription drug coverage); Dental insurance; Vision care; Life insurance; Long term disability; Flexible spending accounts and Vision care discounts. As a result, health policy leadership must be a priority.

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### **Fix it before it breaks**

Despite these and other factors, PEBA staff have done and continue to do an excellent job and morale has remained high, particularly now that the permanent Executive Director has been appointed. Unfortunately, maintaining high quality service at such a low cost of operation is likely unsustainable because of needed investments. Two years have been lost in capability development and the retirement cliff is now just three to five years out. Given the enormity of the task, it is essential that transformation take place at all levels.

It will become increasingly difficult for PEBA to continue to provide service at the same level without a significant investment in time and resources. This will increase costs in the short-term to medium term.

We are concerned that without investment in people and systems, service quality will decline, perhaps significantly. With approaching retirements and legacy language systems, PEBA has a foreseeable time horizon of three to five years to anticipate, plan and transform itself, and the clock is ticking.

PEBA has a staff of 270 positions, including an Executive Director. Funds to pay for the organization and operation of both PEBA and RSIC come from the trust funds. These funds are not State assets. The trust funds come from three sources:

- Active employees
- Their employers
- The return on the investment of those funds

### **A transformation is needed and has already begun.**

A transformation is needed to further develop PEBA's people, processes and systems in order to meet the current and future needs of the beneficiaries. The transformation will require a strategic plan to achieve synergies to prevent a decrease in service levels. It will require a significant increase in the strategic time and attention of the Board and the Executive. It will also require an investment in time and money.

A full-time Executive Director was appointed in July 2014. PEBA is now coalescing under the leadership of the new Executive Director and there have already been significant improvements. Key executive issues are being addressed in the areas of customer service, strategic and operational stakeholder engagement, organizational planning, functional leadership and staffing, budgeting and information systems. PEBA should focus its energies on strategy, organizational development, process redesign and systems improvements.

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**The Board needs to become more strategic and less tactical and delegate more to the Executive Director.**

The Board needs to shift its focus based on our interpretation of the General Assembly's intent. The Board needs to improve its understanding of fiduciary duties, more effectively engage its key stakeholders, and authorize greater delegation to the Executive Director.

Almost since its inception, PEBA has lacked a permanent Executive Director and a number of senior management and manager positions. In the absence of senior leadership and managers, the Board became overly involved in operational matters. Although perhaps necessary at the time, a number of trustees have indicated they realize the board now needs to become more strategic and less operationally involved and rely on the Executive Director to lead the organization day-to-day.

It is timely for the Board to step back into its strategic and oversight roles. Strategic issues to be addressed include, for example:

- Process and system redesign
- Health policy and innovation
- Engagement with key stakeholders
- Gaining the support of the General Assembly

This will require the Board to delegate more to the Executive Director.

**The Executive Director also needs to be able to delegate more responsibilities.**

In the case of one interim Executive Director, there were fifteen direct reports. This is not practical or sustainable if the Executive Director is to play more than a housekeeping role. If the Board is to delegate more to the Executive Director, then there needs to be a cadre of competent executives and staff who can take charge of operational matters to allow the Executive Director to lead the organization. The organization should be formed so that such delegation can occur and is already heading in a positive direction.

**"One size fits one"**

PEBA is at an early stage in its capability development. As its needs change, the organization structure should also adapt and evolve. The organization should be dynamic and its form should

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follow its functions as the organization responds to current and foreseeable demands. One should expect it to change with time and circumstances.

This will require regular evaluation as to whether the current organizational form supports PEBA's essential functions. It will also require training and cross-training for Leadership (succession) and Human Resource planning.

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### **Our Report**

The remainder of this report is organized by chapter according to the eleven elements of Our Scope of Work:

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

### **Chapter Structure**

Within each element, our report follows a standard format.

#### **1. Scope of Review**

The scope of review section describes the topics addressed by this fiduciary performance audit. The scope was defined in the RFP.

#### **2. Standard for Comparison**

The standard for comparison describes the criteria and the methods we used to evaluate each topical area. These criteria include relevant legislation, existing PEBA policies and practices, a comparison to other systems based on CEM reports, a benchmark survey custom designed and conducted specifically for this review and our proprietary knowledgebase of leading practices.

We reviewed documents and conducted interviews within PEBA and with its key stakeholders. We interviewed and accepted submissions from retirees, PEBA board members, executives and staff, investment advisors, vendors, employers and others.

We relied on the expert opinion of our team based on their experience in public retirement systems and other relevant organizations. We offer reasonable (not absolute) independent

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reassurance that our evaluation appropriately reflects the current state of the organization based on the information made available to us.

**3. Summary Conclusions**

This section summarizes the conclusions for each topical area reached as the result of our assessment in this area.

**4. Findings and Recommendations in support of each Conclusion**

This section presents each conclusion and describes our findings that led to the conclusion. We present recommendations where they are warranted. The numbering of the recommendation corresponds to the conclusion. Not all conclusions have recommendations.

**5. Improvement Priorities**

We have assigned a rating of significance and urgency to each recommendation. We consulted with PEBA and have included a prioritization of recommendations in our final report. Each recommendation has been ranked based on whether it is critical, important or should be considered by PEBA as a leading practice. We also describe the degree of difficulty in implementation (high, medium or low), whether the Board, the General Assembly or outside involvement is needed.

**6. Options for Improvement**

In selected cases, we offer options for improvement and an analysis of the various pros and cons associated with each option.

## **Summary of Recommendations**

### **1. GOVERNANCE**

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. Appendix A also describes options for consideration in addressing this Recommendation from the Funston Fiduciary Audit Report on RSIC, which covered some of the same issues.

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.

1.3.1: 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.

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.

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.

1.7: The statutory requirement that the PEBA Board meet monthly throughout the year should be repealed.

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1.8: Training of new Trustees and periodic Board fiduciary education updates should include expanded treatment of the duties of loyalty and impartiality, the different roles of Trustees and plan sponsors and the distinct functions of the Board and staff.

1.9.1: The Board should engage in a deliberative process to develop a conceptual framework governing the delegation of authority and reservation of powers to the Board. Given the inherent conflicts between Trustees and staff in this exercise, consideration should be given to engaging an independent expert to assist with the process.

1.9.2: The Board should continue to prioritize and spend more time on strategic planning, identification of program goals, desired outcomes, implementation strategies, targets and measures to successfully meet PEBA's challenges.

1.9.3: The strategic planning process should give particular consideration to risk identification, compliance issues and staff development, over both short- and long-term (three to five years) time horizons.

1.10: The Board should consider further improving its Bylaws and Committee Charters by:

- Formalizing the process for the development of meeting agendas;
- Creating a Charter for the Executive Committee that includes a framework for evaluation of the Executive Director;
- Removing the provision that Committee members serve at the pleasure of the Board Chairman;
- Establishing procedures for calling a Committee meeting that parallel those for convening a Board meeting;
- Developing position descriptions for Board and Committee officers;
- Creating a Board disciplinary policy;
- Formalizing a process for approving the Board Chairman's educational program attendance and cost reimbursements;
- Including the Board's Self-Assessment process in the Bylaws and using it to identify Trustee training priorities.

1.11: The Board should periodically engage a consultant to facilitate the Board's self-assessment and improvement process, perhaps on a biennial basis.

1.12: The Board should proceed with prioritizing enhancement of PEBA's risk identification, risk management and compliance functions. Consideration should be given to the appropriate assignment of Committee oversight responsibilities for this initiative.

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1:13: The Board should evaluate mechanisms to improve its two-way communication with stakeholders.

## **2. POLICY REVIEW AND DEVELOPMENT**

2.1: To provide the most assistance for Board members in understanding and upholding the ethical requirements, the ethics policy should be expanded to provide an additional framework around the ethical standards.

2.5: PEBA should increase the frequency of its enterprise-wide risk assessment. Currently, one is conducted every five years; however, given the significant changes that have occurred in PEBA's leadership, as well as proposed changes, conducting a more frequent risk assessment would help to ensure that new issues or concerns are promptly identified and prioritized for remediation.

2.6: PEBA should have a formal compensation policy which documents its acknowledgement of its status as a South Carolina State government agency and its compliance with the State's Office of Human Resources policies, job classifications system and pay bands. A simple statement and reference to the State policies to which it adheres would provide transparency of PEBA's compensation policy to its employees and to the public.

2.7.1: Internal Audit should continue to develop a comprehensive risk self-assessment tool for PEBA as an integrated organization.

2.7.2: The development of a risk management policy (including risk appetite and risk tolerance) should be the responsibility of executive management with input from Internal Audit and other stakeholders.

2.7.3: An executive should be assigned responsibility and accountability for the assessment and management of specific risks within each business function and overall based on factors such as impact, velocity and vulnerability. Internal Audit and others can support management in their self-assessments but operating management should be held accountable for the results.

2.7.4: The Board should identify the type and magnitude of risks which ought to come to its attention, e.g., financial, legal, operational, organizational, reputational, strategic.

2.7.5: The Board should require that the presentation of information for all major decisions include a risk assessment including the risk of inaction.

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2.7.6: Internal Audit should focus its audit plans on areas that present the highest inherent risk and which rely most on the effectiveness of controls. Time permitting; Internal Audit should focus its consulting efforts on areas of high inherent risk and low control effectiveness.

2.11.1: PEBA should determine whether it needs additional experienced procurement resources to address upcoming requirements.

2.11.2: PEBA should consider revising its procurement process to provide for a post-audit process by Internal Audit, potentially using a questionnaire.

2.12.1: With most Board members only needing six additional credits after attending the Board's annual retreat, the Board should determine whether the Board members are receiving sufficient training from independent outside sources. If not, the policy should be revised to require additional credits or limit the number of credits from the Board retreat and staff training that can be used to meet training requirements.

2.12.2: The PEBA Trustee Education Policy should specify topics on which training is needed and include mandatory fiduciary training on a periodic basis, and could be linked with the self-assessment process.

### **3. ORGANIZATION STRUCTURE**

3.1.1: PEBA should consider adding the title of Deputy Executive Director to the title of Chief Operating Officer to provide a more streamlined flow of communication between the Executive Director and executive staff, as well as create a succession plan for the Executive Director position.

3.1.2: Over the longer term, PEBA should consider creating the position of a leader of retirement programs who would have responsibility for both defined benefit and defined contribution and savings programs.

3.3: PEBA should continue to fill remaining vacant positions in order to maintain sufficient staffing in all areas to effectively and efficiently perform all functions.

3.4.1: Each PEBA business area should develop a specialized staff training and education policy and program for staff in their area.

3.4.2: Human resources should develop a training policy and program that provides for new employee orientation. New Employee Orientation should include a general organizational overview of PEBA's functions and services.

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3.5.1: The staff training and education policy should provide for cross-training and rotation of staff to other, similarly classified positions within the business functions for cross-training purposes.

3.5.2: Succession planning should be a higher priority. Executive Staff and managers should maintain organizational charts of each business unit that reflect the time remaining to retirement eligibility of individual staff members and regularly discuss anticipated vacancies and plan for future staffing needs and training. The discussion should also include the possibility of back-filling positions where vacancies are anticipated to provide that the replacement is fully trained when the retiring staff member vacates the position.

3.6.1: As the new technology platform and processes are developed, PEBA should implement additional operational consolidations.

3.6.2: The budgeting process for all areas should be more coordinated and collaborative. A formal budget process should be developed and include all department heads in its development. Integration of the budget process will reduce silos and enhance an enterprise approach to administrative functions.

3.8: Each of PEBA's departments should create and maintain a standard operating procedures manual documenting its process for performing its functions.

#### **4. COMMUNICATIONS WITH STAKEHOLDERS**

4.1: PEBA should develop a comprehensive communications strategy and plan.

4.2.1: PEBA should develop the planned consolidated website as soon as practical to improve integration of and access to all information.

4.2.2: The new website should include additional self-service functions to reduce the requirement for submission of paper forms and to provide more member information and tools online.

4.3.1: PEBA should consider mailing newsletters to members with an "opt-out" electronic option for either email delivery or an RSS newsfeed to ensure that all members receive PEBA news on a timely basis.

4.3.2: The PEBA Board should play a more active role in reaching out to employee groups on a regular basis to improve communications.

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4.5.1: Consistent with Recommendation 4.3.1, PEBA could consider mailing newsletters to retirees and survivors with an “opt-out” electronic option for either email delivery or an RSS newsfeed to ensure that all retirees receive PEBA news on a timely basis.

4.5.2: The PEBA Board should consider developing a process and protocol for receiving and considering public comments before its meetings.

4.5.3: Similar to Recommendation 4.3.2, the PEBA Board should play a more active role in reaching out to retiree groups on a regular basis to improve communications.

4.6.1: PEBA should ensure that its new website has significantly improved functionality for accepting online submission of forms and reports.

4.6.2: PEBA communications should review its communications process on legislative changes as they relate to employers and ensure that it results in timely employer updates.

4.6.3: PEBA should determine whether having an employer advisory group to provide feedback in a structured manner would be beneficial.

4.8: As part of its strategic communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with the general public.

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.

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.

4.11: As part of its comprehensive communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with key legislators.

## **5. BENEFIT ADMINISTRATION**

5.1.1: PEBA should continue to maintain internal controls and keep its written policies and procedures current.

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5.1.2: PEBA should revise its written benefits administration procedures to reflect changes required by the new administration software which will be implemented as part of the new benefits platform.

5.3: PEBA should consider expanding the scope of information provided on annual benefit statements.

## **6. ACTUARIAL MATTERS**

6.1: PEBA should determine whether additional assistance from the actuarial team would be beneficial, as identified under Recommendations 6.6, 6.8 and 6.9 below.

6.2: PEBA should develop an internal policy that documents its competitive RFP process in future procurements of actuarial services.

6.4: The actuary, in conjunction with the PEBA staff and subject to approval by the Board, should develop and recommend all actuarial assumptions for the pension plan and other benefit plans. If the state law placing responsibility for setting the investment return assumption with the Legislature is not changed, there should be a prescribed periodic review process adopted by the State Legislature.

6.5: PEBA staff should develop procedures, in conjunction with the actuary, to determine when and how to adopt annuity option factor changes.

6.6: PEBA should consider closer engagement between the PEBA Board, staff, actuary, and the RSIC Board and staff in order to better understand how investment return projections under various asset allocation models may impact plan liabilities and costs.

6.7: PEBA should adopt a policy of conducting regular independent actuarial audits.

6.8: PEBA should consider having the actuary validate the premium rates once PEBA completes the calculation process.

6.9: PEBA should explore additional consulting services for the Health Insurance plans to assist in developing long-term strategies to reduce cost and improve health outcomes.

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**7. LEGAL COMPLIANCE**

7.2: In conjunction with outside legal counsel, PEBA legal staff should continue to perform periodic reviews of changes in the law and the plans' compliance with federal and state law requirements.

7.3: PEBA should review its printed training materials, reports and use of protected health information to make sure its minimum necessary standards are being consistently applied.

7.4.1: PEBA should provide periodic fiduciary training to staff and Board members through standardized onboarding education, regular updates and use of examples that are targeted to key issues.

7.4.2: PEBA should formalize a staff training schedule to ensure that consistent ethics and compliance training is conducted.

7.5: PEBA should confirm that ORP and Deferred Compensation investment advisors acknowledge their compliance with the SEC 'pay to play' regulations and state requirements.

**8. CUSTOMER SERVICE**

8.4: PEBA should develop a more standardized approach for performance monitoring and customer satisfaction surveys with common tools, data and reporting.

8.5.1: PEBA should identify the key areas and metrics for customer service monitoring and develop a comprehensive, integrated customer service monitoring framework which is used to drive its customer surveys and follow-up improvement programs.

8.5.2: The PEBA Customer Service Department should establish a small group with expertise in customer service metrics and monitoring, or conversely, utilize an outside specialist firm to assist in developing its customer service monitoring approach and tools.

8.6: PEBA should re-evaluate its satisfaction surveying process to include single activity surveys for disability, pension inception, withdrawals and transfers-out and service credit purchases.

8.7.1: PEBA should obtain the email addresses of a much higher proportion of its members, particularly retirees, to ensure they receive news electronically.

8.7.2: PEBA should consider alternative means of reaching members if they do not use email or the internet.

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8.8: As PEBA develops its new website, it should place a high emphasis on maximizing self-service capabilities for both members and employers.

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.

8.13.1: PEBA should consider if expanded hours for its call center would result in improved customer service.

8.13.2: PEBA should evaluate new phone and email management systems and consider acquiring newer technologies if they could improve service levels and/or staff productivity levels.

8.14: PEBA should consider whether offering one-on-one counseling sessions at employer sites would result in improved customer service and participation levels.

8.15: PEBA should consider increasing the number of retirement presentations it offers in the field to reduce the size of the groups and allow more individual attention.

8.16: PEBA should consider adding additional information to member statements to help them better understand their future options.

8.17: PEBA should determine if assigning responsibility for monitoring insurance customer service to a single manager in the insurance organization could help focus the reporting and provide helpful input during contract negotiations.

## **9. RECORD KEEPING AND INFORMATION SECURITY**

9.1: PEBA should continue its efforts to conduct a comprehensive assessment of its operational infrastructure and business processes.

9.2: PEBA should continue to conduct annual network and security vulnerability tests to ensure its networks and other infrastructural processes are working as intended. Greater use should be made of in-house based security monitoring tools to identify and protect its networks from unauthorized access and unintentional disclosure of member data.

9.3.1: PEBA should address identified business continuity planning deficiencies.

9.3.2: PEBA should develop and implement a training program for business unit staff in the event the data center recovery plan has to be activated.

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9.4: PEBA should continue its efforts to address the deferred compensation control procedural deficiencies noted by PEBA's staff. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance audit to determine that the control enhancements address the specific concerns noted.

## **10. COST OF OPERATIONS**

10.1: PEBA should review its focus on low cost of retirement operations and ensure there is an adequate level of investment in infrastructure to continue to provide a high level of customer service.

10.2: PEBA should determine if current headcount is adequate in all areas.

10.4: To achieve PEBA's stated strategies of further integration and improved infrastructure, it should request at least a temporary increase in administrative expenses and professional and consulting fees for several years.

10.5: PEBA should increase its budget for health insurance strategy development and planning.

## **11. INFORMATION SYSTEMS TECHNOLOGY**

11.1: PEBA should complete its comprehensive assessment of its existing IT infrastructure and business systems.

11.2: PEBA should increase the frequency of a full enterprise wide risk assessment to ensure that Internal Audit's Plan for the upcoming year reflects the most significant risks to the organization (see also Recommendations 2.7.1 and 2.7.2).

11.3: PEBA should continue its efforts to address the IT control procedural deficiencies noted by their external auditors. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance audit to determine that the control enhancements address the specific concerns noted.

11.4: After the Operational Systems Assessment is completed, the IT department should lead an effort to develop a long-term IT strategic plan which supports the plan infrastructure direction.

11.5: Further efforts need to be made to move from a data center disaster recovery plan orientation to an enterprise wide business continuity focused plan.

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11.6.1: PEBA should continue to move forward with its plans to conduct a comprehensive IT Operations Assessment to identify common business process, technology and develop a roadmap to develop its next generation of systems to support the strategic direction of the organization.

11.6.2: PEBA should continue to assess potential third-party IT vendors which may be able to provide additional legacy “Natural language” programming support in the event a large number of existing PEBA programming staff retire or leave the organization.

11.7: PEBA should continue to work closely with the State’s Information Sharing and Analysis Center (SC-ISAC) along with other third-party information technology consulting firms to proactively assess existing and trending threats to information and network security.

11.8: Issues and error correcting processes should be shared across functional business units to ensure that similar errors in one beneficiary system are also being addressed in other similar application systems.

11.9: The Information Technology Department should consider developing a formal IT user satisfaction feedback process

11.10: As PEBA completes its Operational Systems Assessment it should consider what, if any, additional methodologies and skills will be required for the Information Technology Department to effectively support a new IT plan.

11.11: PEBA should continue its efforts to address its business continuity planning deficiencies.

# **1. GOVERNANCE**

## **1.1 Scope of Review**

We evaluated the roles of the PEBA board, PEBA staff and other relevant state agencies in regard to their oversight and management of Retirement System and Insurance Program policies and operations. This assessment included a review of the established legal and statutory framework and how it has been translated into roles, responsibilities, policies, and procedures. It covered the following topics:

1. Applicable laws, policies and procedures (to include Board of Directors governance manuals, policies and procedures, including co-fiduciary roles)
2. The Board's bylaws and charters - roles and responsibilities of Board members; identification of fiduciaries and/or the existence of "de facto" fiduciaries; fiduciary education; meeting protocols; and the strategic planning and implementation process
3. The role of the Audit Committee in policy compliance and scope of the Audit Committee charter
4. The role of the Board in external financial audits with regard to PEBA's areas of responsibility for retirement and insurance plans and programs
5. The role of the internal audit department and adequacy of audit plans
6. Indemnification/use of fiduciary liability insurance
7. Board, Executive Director, and staff evaluation processes and criteria, and level of delegation of authority to Executive Director (roles and responsibilities)
8. The Board communication policy
9. The Board decision-making process

## **1.2 Standard for Comparison**

We used the Funston Advisory Services Powers Reserved Framework which allows comparison of governance structure to other peers. We also utilized a new PEBA benchmarking survey commissioned specifically for this review and our public pension governance database to identify where South Carolina is consistent with or different from other state public pension fund governance structures and policies. In addition, we referenced the fiduciary standard of conduct applicable to PEBA, conducted external stakeholder and internal interviews, reviewed key documents and utilized the review team's experience in regard to public employee pension and benefit program practices.

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### **1.3 Summary of Governance Conclusions**

*Conclusion 1.1.1: The statutory allocation of Retirement System fiduciary authority and responsibilities amongst PEBA and the other State entities that are either designated as co-trustees or exercise fiduciary powers is uniquely complex, duplicative and confusing. PEBA is exposed to potentially extreme variations over time in interpretation of ambiguous powers that are held by the State Treasurer and by the BCB (and its successors).*

*Conclusion 1.1.2: The complex fiduciary structure in which PEBA operates results in dilution of accountability due to lack of role clarity and misalignment of authority with responsibilities. It also likely increases exposure to fiduciary duty lapses and related liability risk.*

*Conclusion 1.2: PEBA's limited influence over its budget and headcount creates a misalignment of authority with its fiduciary responsibilities. This appears to be fostered (at least in part) by a lack of understanding that PEBA is primarily funded out of earnings on trust assets rather than from appropriation of State tax dollars.*

*Conclusion 1.3: Some allocations of authority that relate to PEBA's fiduciary responsibilities seem to be grounded in historical practices that no longer apply. For example, although the General Assembly established the RSIC to house the State's investment expertise, the State Treasurer still approves deferred compensation investment options and invests insurance program trust fund assets.*

*Conclusion 1.4: The legislative mandate that specified a required number of service providers (four) for the Optional Retirement Plan now limits PEBA's ability to adjust to current industry practices and implement efficiencies that could generate cost reductions without impairing program quality.*

*Conclusion 1.5: Although the Retirement and Pre-Retirement Advisory Panel has been fulfilling a useful role in helping to keep members and retirees informed, it appears to now be somewhat redundant with the PEBA Board of Directors. See also Conclusion 4.9.*

*Conclusion 1.6: The appointment process for PEBA Board members is not consistent with peer practices or with similar South Carolina State entities in regard to length of terms, staggered terms, rigid appointment criteria and service at the pleasure of appointing authorities.*

*Conclusion 1.7: Statutory provisions requiring that the PEBA Board meet monthly are no longer necessary and impair the Board's ability to efficiently structure board and committee meetings to best address scheduling constraints and work flow cycles.*

*Conclusion 1.8: Board members would benefit from greater clarity about application of the fiduciary duty of loyalty, periodic refreshers and a standard protocol for fiduciary training.*

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*Conclusion 1.9.1: While the Board's decision-making process has been reasonably effective, the two-year deferral in the appointment of a permanent Executive Director contributed to a serious delay in the development of PEBA's capabilities.*

*Conclusion 1.9.2: Now that a permanent Executive Director has been hired, the Board would benefit from disciplined application of a powers reserved analysis to provide greater clarity around the distinctly different roles of board and staff and provide context for the delegation of responsibilities to the Executive Director and staff.*

*Conclusion 1.9.3: With the initial PEBA organization tasks accomplished, the Board should now turn more of its attention to strategic planning, including a focus on both short- and long-term goals.*

*Conclusion 1.10: While the Board's Bylaws and Committee Charters provide an appropriate level of guidance, the Board should consider several improvements.*

*Conclusion 1.11: Evaluation processes for the Board, Executive Director and staff appear to be adequate and consistent with peer practices. However, as a leading practice, the Board could consider engagement of a third party facilitator to assist with the Board evaluation process.*

*Conclusion 1.12.1: With a permanent Executive Director in place, risk management and compliance oversight functions should be prioritized, and consideration should be given to assigning risk identification and management oversight to a specific committee.*

*Conclusion 1.12.2: Board and Committee oversight of the audit process could be improved through further strengthening of the internal audit function. (See also the text accompanying Conclusion 2.5 for related comments.)*

*Conclusion 1.13: The PEBA Board does not currently have a communication policy (See Section 4 for additional comments).*

*Conclusion 1.14: PEBA's indemnification policy and fiduciary insurance coverage are consistent with other public pension funds.*

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## **1.4 Findings and Recommendations for each Governance Conclusion**

### **Background**

Although its predecessor organizations had existed for quite some time, PEBA is a relatively young organization, having been created on July 1, 2012 through the merger of separate retirement system and insurance programs. Responsibility for administration of the Deferred Compensation program was added as recently as early 2014. Given the challenges of integrating separate programs, creating a new entity and developing procedures for a new board, it is to be expected that PEBA's governance policies and practices are a 'work in process.' In the broader context, we believe that PEBA currently fares well even when compared to its more established peers.

However, a prudent fiduciary is, by definition, one that is prepared for the future. Our recommendations focus on governance improvements to help PEBA prepare for coming challenges while achieving the program and service integration goals for which it was created.

The fiduciary standard that applies to PEBA is found in the South Carolina Code of Laws, Section 9-16-40. It governs the conduct of all named trustees and fiduciaries of the Retirement System and provides as follows.

*Standards for discharge of duty. A trustee, commission member, or other fiduciary shall discharge duties with respect to a retirement system:*

- (1) solely in the interest of the retirement systems, participants, and beneficiaries;*
- (2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;*
- (3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;*
- (4) impartially, taking into account any differing interests of participants and beneficiaries;*
- (5) incurring only costs that are appropriate and reasonable; and*
- (6) in accordance with a good faith interpretation of this chapter.*

While this Report is not a legal opinion regarding PEBA's responsibilities, a general understanding of several aspects of fiduciary duty is particularly important for an evaluation of

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governance practices. First, trustees and other fiduciaries must act solely in the interest of the retirement system, participants and beneficiaries. They have a fiduciary duty to not be influenced by the interests of any third person or by motives other than the purposes of the trust funds which are being administered.

For example, a Board member cannot be motivated to appease or benefit the taxpayers or the officer who appointed the Trustee to PEBA. That does not mean that the interests of taxpayers and the political constraints within which PEBA operates cannot be considered. However, it does require that those factors be evaluated for the purpose of serving the trust funds, participants and beneficiaries.

Second, PEBA Trustees have a duty to administer the trust fund programs in a manner that is impartial with respect to the various beneficiaries. Impartial does not necessarily mean equal, but it does require that a trustee's conduct in administration of the trust should not be influenced by favoritism (or animosity) toward any individual beneficiary or group of beneficiaries.

Rather, Trustees must make diligent and good faith efforts to identify, respect and balance the varying beneficial interests under the trust. For example, program assets cannot be used to treat employees at different employers unfairly. That does not necessarily require equal treatment, but Trustees cannot divert trust assets to a set (or subset) of employers that would unreasonably benefit certain employees at the expense of other beneficiaries. In addition, although Trustees are appointed from various constituencies, they represent and owe the same fiduciary duties to all participants and beneficiaries. Trustees cannot favor the constituency from which they were appointed, nor can they ignore or disfavor other groups.

Third, common law contains an obligation for Trustees to respond to apparent fiduciary misconduct by other statutorily-designated trustees and fiduciaries. In addition, failure to prudently select, instruct and monitor agents to which PEBA has delegated fiduciary responsibilities can lead to co-fiduciary liability. Consequently, it seems likely that a court would find each PEBA Trustee to have an obligation to take preventative or remedial actions in response to an apparent fiduciary breach (intentional or unintentional) by the other named trust fund trustees or fiduciaries. To be clear, this does not mean that co-fiduciaries have a responsibility to second-guess or interfere with duties that have been statutorily delegated to another fiduciary. It contemplates an "eyes open but nose out" position that precludes turning a blind eye toward co-fiduciary misconduct.

Finally, the fiduciary duties that are applicable to Trustees impose stricter and more extensive standards of conduct than those that apply to other public officials. Trustees are also held to a higher standard of conduct than corporate directors. For example, the Trustees' duty of loyalty

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generally precludes them from self-dealing or conflicts of interest, whereas corporate fiduciaries are permitted to enter into related-party transactions involving conflicts if they are fair to the company or if they are otherwise disclosed and approved.

These fiduciary standards are central to the design and implementation of PEBA's governance policies and practices. They also inform our Recommendations (a more detailed description of the legal principles that affect PEBA is contained in *Appendix A: PEBA Fiduciary and Governance Legal Issues*).

### **Fiduciary Complexity and Ambiguity**

**Conclusion 1.1.1: The statutory allocation of Retirement System fiduciary authority and responsibilities amongst PEBA and the other State entities that are either designated as co-trustees or exercise fiduciary powers is uniquely complex, duplicative and confusing. PEBA is exposed to potentially extreme variations over time in interpretation of ambiguous powers that are held by the State Treasurer and by the BCB (and its successors).**

**Conclusion 1.1.2: The complex fiduciary structure in which PEBA operates results in dilution of accountability due to lack of role clarity and misalignment of authority with responsibilities. It also likely increases exposure to fiduciary duty lapses and related liability risk.**

In addition to PEBA, there are currently at least eight entities that exercise fiduciary powers over the retirement or insurance programs. The following chart illustrates the complexity and overlapping authority presented by this governance structure.

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**Table 1 PEBA Fiduciary Authorities**

| Fiduciary Authorities                                                                                                                                                                                                                                                                                                                                                                                                       |                                                                                                                                                                                                                                                                                                                                                                                        |                                                                                                                                                                                                                                                                        |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <div>Legislature</div> <p><b>Policy and Legal Framework:</b></p> <ul style="list-style-type: none"> <li>• Sets PEBA legal authorities</li> <li>• Sets retirement fund assumed rate of return</li> </ul> <p><b>Oversight:</b></p> <ul style="list-style-type: none"> <li>• Approves budget annually</li> <li>• Approves headcount annually</li> </ul>                                                                        | <div>Budget &amp; Control Board</div> <p><b>Named Co-Trustee and Fiduciary Policy and Legal Framework:</b></p> <ul style="list-style-type: none"> <li>• Approves PEBA purchasing practices</li> <li>• Appoints 7 of 11 PEBA Trustees</li> <li>• Approves insurance premium and coverage changes</li> <li>• Approves retirement actuarial assumptions and contribution rates</li> </ul> | <div>State Treasurer</div> <p><b>Fiduciary Responsibilities:</b></p> <ul style="list-style-type: none"> <li>• Custodian of the funds</li> <li>• RSIC Commissioner</li> <li>• Members of Budget &amp; Control Board</li> <li>• Manages insurance investments</li> </ul> |
| <div>Public Employee Benefit Authority</div> <p><b>Named Co-Trustee and Fiduciary Responsibilities:</b></p> <ul style="list-style-type: none"> <li>• Administers retirement and insurance benefits</li> <li>• Administers deferred compensation and defined contribution plans</li> <li>• Provides investment accounting and financial reporting</li> <li>• Directs external auditing</li> <li>• Engages actuary</li> </ul> | <div>Retirement System Investment Commission</div> <p><b>Fiduciary Responsibilities:</b></p> <ul style="list-style-type: none"> <li>• Invests and manages pension and insurance funds</li> <li>• Provides valuations for financial reports</li> <li>• PEBA Executive Director serves as non-voting Commissioner</li> </ul>                                                             | <div>Attorney General</div> <p><b>Oversight:</b></p> <ul style="list-style-type: none"> <li>• Approves retention and rates of external counsel</li> <li>• Approves hiring of temporary internal counsel</li> </ul>                                                     |
| <div>Comptroller General</div> <p><b>Oversight:</b></p> <ul style="list-style-type: none"> <li>• Conducts accounts payable and payroll procedures audit</li> </ul>                                                                                                                                                                                                                                                          | <div>Inspector General</div> <p><b>Oversight:</b></p> <ul style="list-style-type: none"> <li>• Conducts annual fiduciary performance review</li> </ul>                                                                                                                                                                                                                                 | <div>State Auditor</div> <p><b>Oversight:</b></p> <ul style="list-style-type: none"> <li>• Selects external auditor</li> </ul>                                                                                                                                         |

This structure is unique amongst public pension funds and includes multiple overlapping and circular allocations of authority for fiduciary decisions. For example, the BCB is statutorily designated as a named trustee of the retirement system, making it subject to the same fiduciary duties as PEBA. Members of the BCB also appoint seven of the PEBA Board members, who serve at the appointing authority's pleasure and can apparently be removed without cause at any time.

The BCB's status as a named trustee likely also imposes common law co-fiduciary monitoring obligations on it, though the extent of those overlapping obligations is unclear. The BCB also holds approval powers over many of PEBA's statutorily assigned duties. PEBA policy decisions on Employee Insurance Program coverage changes and premium increases, as well as Retirement System decisions on actuarial assumptions and adjustments in employer and employee contributions, are all subject to approval by the BCB (or its successor).

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As a result, although the Retirement System is statutorily placed under management of PEBA and PEBA is directed by statute to manage the health and other insurance benefit plans, the BCB (and its successors) have a great amount of control over PEBA. The extent to which that could make the BCB (and its successors) a controlling co-fiduciary with primary fiduciary liability is unclear.

Similarly, the State Treasurer occupies multiple fiduciary roles with inherently inconsistent and overlapping functions. For example, the Treasurer is a member of the BCB, a Commissioner on the RSIC, an "other fiduciary" by virtue of being the sole custodian for the Retirement System, a statutory custodian and investment manager for the retiree health insurance trust and an approval authority for investment options of the deferred compensation program. As a member of the BCB, the Treasurer appears to have fiduciary responsibility for oversight of his role in the other fiduciary functions. In addition, as a member of the BCB, he is responsible for oversight of PEBA in its administration of trust assets that are held in custody and invested by the Treasurer.

The inherent potential for confusion and conflict in this complex fiduciary governance structure is, in our opinion, unprecedented. These governance arrangements encourage conflicts between fiduciaries, dilute accountability and foster sub-optimal decision-making, even when all parties are acting in good faith. (Further commentary is included in *Appendix A: PEBA Fiduciary and Governance Legal Issues*.)

**Recommendation 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. Appendix A also describes options for consideration in addressing this Recommendation from the Funston Fiduciary Audit Report on RSIC, which covered some of the same issues.**

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## **Alignment of Authority and Fiduciary Responsibilities**

**Conclusion 1.2: PEBA's limited influence over its budget and headcount creates a misalignment of authority with its fiduciary responsibilities. This appears to be fostered (at least in part) by a lack of understanding that PEBA is primarily funded out of earnings on trust assets rather than from appropriation of State tax dollars.**

PEBA was established to provide a unified source for participating public employers and covered employees in regard to the delivery of retirement and insurance benefits. However, the confusing system of governance described above can frustrate efforts to effectively and efficiently deliver those services. The overlapping governance powers also undermine PEBA's accountability, since PEBA does not possess the clear authority or resources needed to perform its responsibilities.

In addition, governance dysfunctions serve as a distraction and use PEBA resources that should be spent on its primary functions. For example, recent disputes over securities lending losses and the legislative proviso which required PEBA to investigate and report on the Bank of New York Mellon securities lending settlement were some of a series of recent governance problems that have diverted PEBA's attention from its core mission.

PEBA is not staffed adequately to deal with these distractions. The CEM study (see Appendix B) found that PEBA is thinly staffed compared to its peers. Our benchmark survey (see Appendix C) showed that the ratio of PEBA's full time employees per number of Retirement System and insurance beneficiaries covered is substantially below the median of PEBA's peers.

While PEBA has been able to adequately perform its services at present (while operating with systems that are becoming rapidly outdated and with much of its most experienced staff nearing retirement), we think it is unlikely that PEBA will be able to meet coming challenges and the changing program standards of other public and private funds within current budget and staffing constraints. Over time, the risk of errors, degrading levels of service and increasing exposure to fiduciary liability will inevitably rise if the situation is not resolved.

The General Assembly's control over PEBA's budget and headcount are critical powers that affect PEBA's ability to perform its responsibilities. Unlike other State entities, PEBA has fiduciary obligations to discharge its duties with the care, skill, and caution exercised by similar funds and may "incur only costs that are appropriate and reasonable." These fiduciary standards set legally binding standards of conduct in management of the retirement and insurance programs which are much more stringent than those that apply to other public officials.

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Because of these strict legal obligations, fiduciaries are often granted a greater level of independence than other public officials. The Uniform Management of Public Employee Retirement Systems Act (UMPERSA) explains the basis for this greater independence.

*[It] permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging (and possibly conflicting) set of interests*

It is also important to stress that Retirement System funds are statutorily designated as "not funds of the State," and are required to be held in trust for the intended beneficiaries. Assets of the South Carolina Retiree Health Insurance Trust fund and the South Carolina Long Term Disability Insurance Trust fund are also statutory trust funds which are separate and distinct from general funds of the State. Even other insurance funds that are placed in a separate Treasury account appear to be held in an informal trust arrangement (see *Appendix A: PEBA Fiduciary and Governance Legal Issues*).

Indeed, PEBA's operating budget comes from earnings on trust assets that are not State funds and are not appropriated tax dollars. PEBA budgeting decisions do not have the same effect on tax monies as general budget appropriations. Rather, PEBA resourcing decisions involve application of the fiduciary obligations to observe due care in meeting the fiduciary standard of prudence and are automatically limited by the obligation to incur only costs that are reasonable and appropriate (see *Appendix A* for a more detailed description of the legal principles described in this section).

This is particularly relevant because the CEM Benchmarking Analysis found that PEBA's budget expenditure per Retirement System Member (active and retired) was the lowest among its peers, while PEBA's score for member/pensioner service was below the peer median. It appears that PEBA's limited operating budget could be affecting its ability to provide a level of service that is comparable to its peers (see page 21 of the CEM Benchmarking Analysis attached as *Appendix B*).

In addition, half of the peers in our benchmark survey reported that they have more budget flexibility than PEBA.

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**Table 2 Budgetary Autonomy**

| <b>Which statement best describes your organization's process for establishing its annual operating budget and spending authority?</b> | <b>N = 7</b> |
|----------------------------------------------------------------------------------------------------------------------------------------|--------------|
| Our retirement system trustees have the authority to set our budget without legislative approval                                       | 1            |
| Our retirement system trustees establish our budget and report it to the legislature                                                   | 0            |
| Our retirement system trustees establish our budget and submit it to the legislature                                                   | 1            |
| Our retirement system is part of the annual state budget setting process                                                               | 4            |
| Our retirement system trustees can budget and spend up to a fixed percentage of our plan liability without legislative review          | 1            |

Highlighted box indicates PEBA response.

**Recommendation 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.

### **Addressing Outdated Statutes**

**Conclusion 1.3:** Some allocations of authority that relate to PEBA's fiduciary responsibilities seem to be grounded in historical practices that no longer apply. For example, although the General Assembly established the RSIC to house the State's investment expertise, the State Treasurer still approves deferred compensation investment options and invests insurance program trust fund assets.

There are several PEBA governance practices and statutory provisions that seem to have outlived their original purposes. In some instances they now impede cost saving efforts or result in practices which do not take advantage of better alternatives that have become available. In other cases, new entities have been created or improved practices have been adopted elsewhere that could offer upgraded models for PEBA.

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For example, RSIC was created in 2005 to handle Retirement System investment functions that had been housed with the BCB and State Treasurer. The General Assembly transferred those investment functions to RSIC. The statutes also contain provisions to transfer investment functions for the Retiree Health Insurance Trust Fund and Long Term Disability Insurance Trust Fund from the State Treasurer to RSIC upon ratification of an amendment to the South Carolina Constitution allowing funds allowing them to be invested in equity securities.

However, since the constitutional amendment has not yet been ratified, there still are legacy investment functions involving insurance programs administered by PEBA that have not been transferred to RSIC, the State's established investment expert. During our review, PEBA's external auditor identified potential concerns with the adequacy of account information and reconciliations from the State Treasurer regarding allocation of securities lending losses between the Retiree Health Insurance Trust fund and other accounts managed by the Treasurer. Regardless of the outcome, this further exacerbates the issues described above in the section on Alignment of Authority and Fiduciary Responsibilities.

Since fiduciary authority for investments is not fully aligned with relevant fiduciary expertise and responsibility, unnecessary additional burdens are placed PEBA to deal with the consequences. Resulting distractions, as well as added demands on staff time and resources, undermine PEBA's ability to devote needed attention to its primary fiduciary responsibilities.

The FAS benchmark survey found that the prevailing practice at PEBA's peers is not to vest retirement or insurance investment management functions with the Treasurer. Only one of the six peer funds in our survey reported that the State Treasurer manages investments for either their retirement or insurance plans.

In this context, status of the constitutional amendment referenced in the South Carolina Code and investment arrangements for the insurance funds should be re-evaluated.

**Recommendation 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.**

**Recommendation 1.3.2: The General Assembly should transfer approval of Deferred Compensation investment options from the State Treasurer to the PEBA Board of Trustees.**

**Conclusion 1.4: The legislative mandate that specified a required number of service providers (four) for the Optional Retirement Plan now limits PEBA's ability to adjust to current industry**

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**practices and implement efficiencies that could generate cost reductions without impairing program quality.**

Similarly, the legislative mandate that requires four vendors for the Optional Retirement Plan (ORP) originally provided additional choices to participants without significant cost ramifications. That was when the ORP was a small fund. Significant improvements have been made to the ORP since PEBA assumed responsibility for it, and further program enhancements are contemplated. ORP assets have grown substantially since the option was created, which now offers potential for new service upgrades. However, it now appears that the four vendor requirement could hamper obtaining some additional improvements, including more competitive, lower costs.

**Recommendation 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.**

## **Legal Structure**

**Conclusion 1.5: Although the Retirement and Pre-Retirement Advisory Panel has been fulfilling a useful role in helping to keep members and retirees informed, it appears to now be somewhat redundant with the PEBA Board of Directors. See also Conclusion 4.9.**

The Retirement and Pre-Retirement Advisory Panel, which was established to advise the BCB before the establishment of PEBA, was created when the BCB was the only Trustee of the Retirement Systems and member representation was not otherwise available. The Panel is directed to meet annually by S.C. Code Ann. §§ 9-2-30 and 9-2-40 to review retirement and preretirement programs and policies, propose recommendations, and identify major issues for consideration. However, given the new structure of the PEBA Board, which has representative members who serve as Board members, the General Assembly should reconsider the intended original purpose for the Retirement and Pre-Retirement Advisory Panel and determine if that original purpose is now being met by PEBA.

Receiving stakeholder input is critically important to the proper functioning of the PEBA Board. However, having two separate Boards (the Retirement and Pre-Retirement Advisory Panel and PEBA) is not ideal. There has been little interaction between the panel and the PEBA Trustees or members of the BCB. While the panel could be restored by PEBA to play a more effective advisory role, an effective PEBA stakeholder engagement and communication plan would likely achieve the same goals. Improved communication and engagement between PEBA and fund participants could be achieved by replacing the panel with a broader outreach program which

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could include convening regular direct forums involving PEBA Trustees, staff, participant groups and other stakeholders.

**Recommendation 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.**

**Conclusion 1.6: The appointment process for PEBA Board members is not consistent with peer practices or with similar South Carolina State entities in regard to length of terms, staggered terms, rigid appointment criteria and service at the pleasure of appointing authorities.**

The composition of the PEBA Board is fairly consistent with boards at peer funds, although PEBA is one of only two agencies in the peer group that has all appointed members. Four of the seven peer boards have elected members and four have ex officio members.

**Table 3 Board Composition**

|                          | Ex-Officio |     |     |      | Appointed |     |     |      | Elected |     |     |      | Total |     |     |      |
|--------------------------|------------|-----|-----|------|-----------|-----|-----|------|---------|-----|-----|------|-------|-----|-----|------|
|                          | Min        | Max | Med | PEBA | Min       | Max | Med | PEBA | Min     | Max | Med | PEBA | Min   | Max | Med | PEBA |
| State Officers           | 0          | 3   | 1   | 0    | 0         | 1   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 3   | 1   | 0    |
| Plan Participants        | 0          | 0   | 0   | 0    | 0         | 6   | 1   | 3    | 0       | 6   | 1   | 0    | 1     | 6   | 5   | 3    |
| Retirees                 | 0          | 0   | 0   | 0    | 0         | 2   | 0   | 1    | 0       | 2   | 1   | 0    | 0     | 2   | 1   | 1    |
| Members of the Public    | 0          | 0   | 0   | 0    | 1         | 7   | 4   | 7    | 0       | 0   | 0   | 0    | 1     | 7   | 4   | 7    |
| Industry Representatives | 0          | 0   | 0   | 0    | 0         | 0   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 0   | 0   | 0    |
| Employer Representatives | 0          | 1   | 0   | 0    | 0         | 2   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 2   | 0   | 0    |
| Total                    | 0          | 4   | 1   | 0    | 4         | 11  | 5   | 11   | 0       | 7   | 2   | 0    | 5     | 13  | 11  | 11   |

However, while the statutory provisions governing appointment of PEBA Trustees might have been a natural outgrowth of the legislative calendar in place at the BCB when the retirement and insurance benefits programs were transferred from the BCB to PEBA, they are inconsistent with peer practices and with the appointment process used for similar South Carolina State

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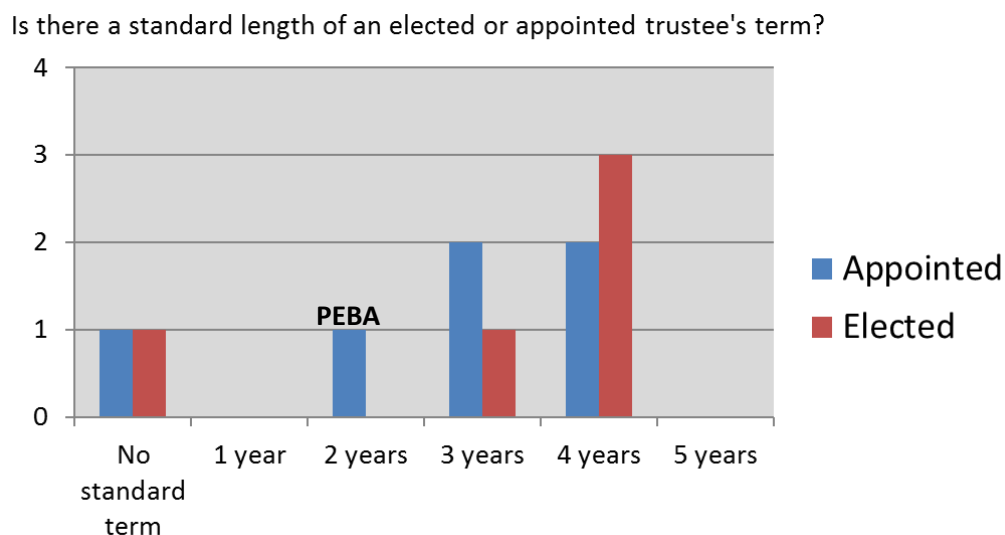
entities. Furthermore, we identified concerns that the appointment categories from which General Assembly leaders must make appointments, although intended to provide representative balance on the Board, are arbitrarily restrictive.

PEBA Board Members are appointed to two-year terms, all of which begin on July first in even-numbered years, and serve at the pleasure of their appointing authorities. In addition to experience and education qualifications, there are specific criteria for each of the Board Members that are appointed by leaders in the General Assembly:

- The two members appointed by the President Pro Tempore of the Senate must include a non-representative member and one who is either an active or retired member of the South Carolina Police Officers Retirement System (SCPORS);
- The two members appointed by the Chairman of the Senate Finance Committee must include a non-representative member and one who is a retired member of the South Carolina Retirement Systems (SCRS);
- The two members appointed by the Speaker of the House of Representatives must include a non-representative member and one who is an active contributing State employee member of the SCRS;
- The two members appointed by the Chairman of the House Ways and Means Committee must include a non-representative member and one who is an active contributing public school district member of the SCRS.

The FAS benchmark survey showed that the two-year term for PEBA appointees was shorter than the term for trustees at any peer fund. The most common length for trustee terms is four years.

**Table 4 Standard Length of Trustee Terms**



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We also surveyed the peer group regarding the practice of having staggered terms. The prevailing practice, as shown below, is to stagger terms to ensure continuity.

**Table 5 Use of Staggered Terms**

|                                                   | Yes | No |
|---------------------------------------------------|-----|----|
| Are trustee terms staggered to ensure continuity? | 5   | 2  |

Highlighted box indicates PEBA response

None of the peer funds allow trustees to be removed by the appointing authority without cause.

**Table 6 Removal of Trustees**

| Can a trustee be removed for any reason, including for cause? (n=5 – two indicated laws are unclear) | Yes | No |
|------------------------------------------------------------------------------------------------------|-----|----|
| By the Governor                                                                                      | 1   | 4  |
| By the Legislature                                                                                   | 0   | 5  |
| By the State Attorney General                                                                        | 0   | 5  |
| By the trustee's appointing authority                                                                | 1   | 4  |
| By fellow trustees                                                                                   | 2   | 3  |

Highlighted boxes indicates PEBA responses

While experience qualification requirements are common for appointed trustees, PEBA's are by far the most specific and stringent.

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**Table 7 Trustee Qualifications**

| Appointed members. N=6                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Yes | No | Not Applicable |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----|----------------|
| Are specific qualifications required for trustees? If so, what are they?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | 4   | 2  | 1              |
| Comments:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |     |    |                |
| Must be competent by training or experience in finance, accounting or pensions.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |     |    |                |
| One must have at least five years of experience in actuarial analysis, administration of an employee benefit plan, or significant administrative responsibility in a major insurer                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |     |    |                |
| Three members of the board must have experience in business management, pension management or investing.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |     |    |                |
| <p>PEBA: A non-representative member may not be appointed to the board unless the person possesses at least one of the following qualifications: (a) at least twelve years of professional experience in the financial management of pensions or insurance plans; (b) at least twelve years academic experience and holds a bachelor's or higher degree from a college or university as classified by the Carnegie Foundation; (c) at least twelve years of professional experience as a certified public accountant with financial management, pension, or insurance audit expertise; (d) at least twelve years as a Certified Financial Planner credentialed by the Certified Financial Planner Board of Standards; or (e) at least twelve years membership in the South Carolina Bar and extensive experience in one or more of the following areas of law: (i) taxation; (ii) insurance; (iii) health care; (iv) securities; (v) corporate; (vi) finance; or (vii) the Employment Retirement Income Security Act (ERISA). (2) A representative member may not be appointed to the board unless the person: (a) possesses one of the qualifications set forth in item (1); or (b) has at least twelve years of public employment experience and holds a bachelor's degree from a college or university as classified by the Carnegie Foundation.</p> |     |    |                |

In addition, the PEBA appointment process is quite different than what is used for RSIC Commissioners and for the Retirement and Pre-Retirement Advisory Panel (RPAP). RSIC Commissioners are appointed for five-year terms and may only be removed by the Governor for malfeasance, misfeasance, incompetency, absenteeism, conflicts of interest, misconduct, persistent neglect of duty in office, or incapacity. RPAP members are appointed for four-year terms and are limited to serving two consecutive terms.

If the General Assembly eliminates the RPAP (see Recommendation 1.5), the BCB might want to develop a process that involves the PEBA Board and participant groups in identifying potential selection criteria and candidates for appointments to the PEBA Board. This would ensure that the BCB has ongoing stakeholder interaction and could supplement PEBA's stakeholder communications plan.

It could also expand the candidate sourcing process. In addition, it might fit with our recommendation for the PEBA Board to become more proactive in periodically evaluating the Board's collective capabilities against a desired skill set matrix to coordinate Trustee education

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priorities (and potentially identification of Board Member candidates) with development of needed Board capabilities. (See the discussion following Conclusion 1.11.)

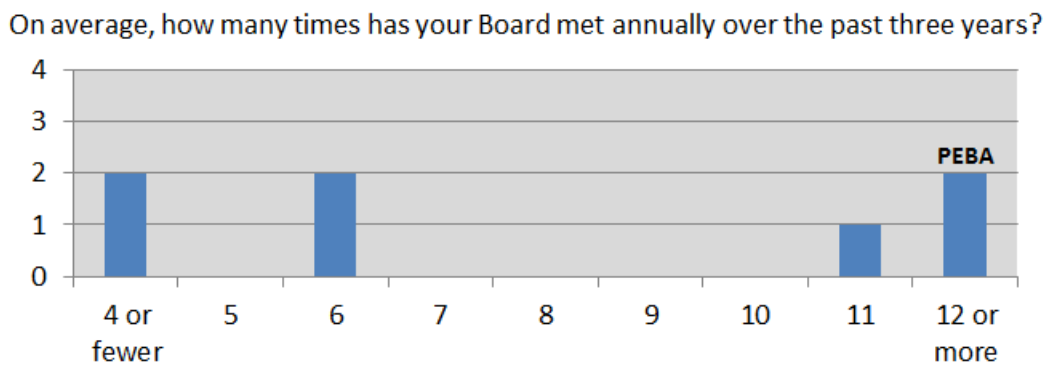
**Recommendation 1.6: The General Assembly should update the PEBA Board Member appointment process to be more consistent with peer practices. This should include consideration of four- or five-year staggered terms, subject only to early removal for cause. It might also include consideration of changes 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.**

**Conclusion 1.7: Statutory provisions requiring that the PEBA Board meet monthly are no longer necessary and impair the Board's ability to efficiently structure board and committee meetings to best address scheduling constraints and work flow cycles.**

While it was important that the PEBA Board meet monthly during the agency and Board formation phase, the need for monthly Board meetings no longer appears to be necessary. Nevertheless, the Board is required by Statute to meet every month. Our interviews identified wide agreement on the need for greater flexibility in scheduling board and committee meetings to meet scheduling and work flow requirements. Length and intensity of Board meetings has lessened, particularly since the appointment of the permanent Executive Director.

In addition, our benchmark survey found that four of six peer agencies meet six times per year or less and only one other had monthly meetings similar to PEBA.

Table 8 Most Peer Boards Meet Less Often Each Year than PEBA



**Recommendation 1.7: The statutory requirement that the PEBA Board meet monthly throughout the year should be repealed.**

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## **Board Delegation, Powers Reserved and Strategic Focus**

**Conclusion 1.8: Board members would benefit from greater clarity about application of the fiduciary duty of loyalty, periodic refreshers and a standard protocol for fiduciary training.**

Our interviews identified broad agreement that the Board, as a new governing body, has not yet fully developed mature governance practices. The two-year deferral in appointment of a permanent Executive Director (though it was also the result of the General Assembly's one-year delay in extending the State's indemnification provision to cover PEBA and the statutory grant of authority to the Governor and the Chairmen of the House Ways and Means Committee and the Senate Finance Committee to jointly appoint the Executive Director through December 31, 2013), along with the Board's acknowledged drift into management and operational details during this period of transitional executive leadership, illustrate difficulties that the Board has experienced.

Several related themes became evident during this review.

Greater clarity about fiduciary duties is needed to help the Board better understand its role. More focus on practical application of the duties of loyalty and impartiality seem to be especially relevant. For example, there appears to be confusion about whether Trustees have a fiduciary duty to taxpayers and appointing authorities. (See the discussion in Appendix A of the fiduciary obligation to impartially discharge duties solely in the interests of the retirement system, participants and beneficiaries, without subordinating those interests to personal agendas or the interests of other parties.)

There also seem to be misconceptions about whether Trustees represent only the interests of the group from which they were appointed or whether they have an impartial fiduciary duty to look after the interests of all fund participants and beneficiaries. (See also Appendix A.)

**Recommendation 1.8: Training of new Trustees and periodic Board fiduciary education updates should include expanded treatment of the duties of loyalty and impartiality, the different roles of Trustees and plan sponsors and the distinct functions of the Board and staff. (See also the text accompanying Conclusion 7.4 for related discussion.)**

**Conclusion 1.9.1: While the Board's decision-making process has been reasonably effective, the two-year deferral in the appointment of a permanent Executive Director contributed to a serious delay in the development of PEBA's capabilities.**

**Conclusion 1.9.2: Now that a permanent Executive Director has been hired, the Board would benefit from disciplined application of a powers reserved analysis to provide greater clarity**

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**around the distinctly different roles of board and staff and provide context for the delegation of responsibilities to the Executive Director and staff.**

**Conclusion 1.9.3: With the initial PEBA organization tasks accomplished, the Board should now turn more of its attention to strategic planning, including a focus on both short- and long-term goals.**

Attention should be brought to the different functions of trustees and employers in regard to plan and benefit structure versus program implementation. We heard different opinions about whether (and how far) the Board should go in shaping the design of PEBA's programs.

An improved understanding is also required of the distinctly separate functions of the board as a policy and oversight body and the staff as operational entity that implements the board's policies. Trustees and staff both acknowledged that the dividing line between these roles moved significantly during the years without a permanent Executive Director.

A more deliberative organizing framework for delegating powers to staff and for determining what decision authority should be retained by the Board would help the Board establish priorities, identify goals and refocus on strategic issues. A list of potential powers reserved framework that was developed by Funston Advisory Services includes:

Set / approve board administrative policies and processes

1. Promote effective stakeholder relations and advocate for beneficial legislation
2. Set mission and oversee performance
3. Set enterprise strategy and budgets
4. Set / approve board governance processes
5. Select executive management, evaluate and set compensation
6. Set investment strategies and oversee ongoing investment performance.
7. Set / Approve enterprise risk policy framework and oversee effectiveness of enterprise risk management
8. Oversee ethics and enterprise policy compliance

While the PEBA Trustees have made appropriate delegations, we were unable to identify a consistent understanding of what tasks should be delegated and why. The Table below provides suggested categories around which a framework could be developed to organize the Board's powers reserved.

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**Table 9 Suggested Framework for Board Authority Analysis**

| Authority       | Description                                                                                                                                                                                                   |
|-----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <i>Conduct:</i> | The board performs the tasks described.                                                                                                                                                                       |
| <i>Set:</i>     | The board is actively engaged in developing the strategies and plans for the delegated activities and has final approval authority.                                                                           |
| <i>Approve:</i> | The board has final decision authority on delegated activities.                                                                                                                                               |
| <i>Oversee:</i> | The board requires adequate information to watch over, scrutinize, and provide direction and support, as appropriate (as distinct from close supervision and day-to-day management), on delegated activities. |

This review also identified a transition from basic organizational tasks during the phase where the focus was on development of a new organization to a more mature phase with a focus on strategic planning. Now that a permanent Executive Director is in place, it appears that this phase can move forward. Accordingly, it is important that PEBA's nascent strategic planning and risk identification process focus on both near- and long-term (at least three to five years out) time frames.

PEBA's current annual plan, which primarily addresses goals and operational priorities, should be supplemented with a three- to five-year plan that is more strategic. Longer-term planning is needed to both identify and prepare for coming challenges (such as staff turnover, aging technologies, demographic changes, evolving best practices) and to prioritize completion of PEBA's near-term program and service integration goals (such as fully combining similar program functions and consistently delivering competitive retirement and insurance program services).

**Recommendation 1.9.1: The Board should engage in a deliberative process to develop a conceptual framework governing delegation of authority and reservation of powers to the Board. Given the inherent conflicts between Trustees and staff in this exercise, consideration should be given to engaging an independent expert to assist with the process.**

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**Recommendation 1.9.2: The Board should continue to prioritize and spend more time on strategic planning, identification of program goals, desired outcomes, implementation strategies, targets and measures to successfully meet PEBA's challenges.**

**Recommendation 1.9.3: The strategic planning process should give particular consideration to risk identification, compliance issues and staff development, over both short- and long-term (three to five years) time horizons.**

## **Board Bylaws and Committee Charters**

**Conclusion 1.10: While the Board's Bylaws and Committee Charters provide an appropriate level of guidance, the Board should consider several improvements.**

The Board's Bylaws and Committee Charters are generally consistent with those of peers and cover most of the topics that are typically included in governance documents. However, there are several items that merit consideration by the Board.

While the Board's meeting minutes reflect an open and inclusive process for addition of agenda items at the beginning of each meeting, the Bylaws provide only a cursory mention of the process for developing meeting agendas (i.e., the Chairman shall propose agendas for Board meetings). The Committee Charters merely reference adherence to rules outlined in the Bylaws. In order to avoid potential future disputes over Trustee and Executive Director input into the agenda setting process, the Board should consider formalizing its process for establishing and approving agendas.

While the Bylaws provide for establishment of an Executive Committee, we did not locate a Charter for that Committee. If the Executive Committee is still in existence, the Board should establish a formal Charter for it. If the Committee remains in charge of evaluation of the Executive Director, it should contain a framework for conducting the evaluation.

We note that the process for appointment of Committee members contains the same provision that is in the Statutes for appointment of PEBA members in regard to service at the pleasure of the appointing authority (in this case, the Board Chairman). Given that we are recommending removal of that statutory provision, we recommend that the Board also consider removing the ability of the Chairman to remove Committee members at any time without cause. An alternative removal process, such as a vote of the Board, could be provided.

The Bylaws allow a Board meeting to be called by the Board Chairman, Executive Director or any two members of the Executive Committee. However, the Committee Charters only provide for the Committee Chairman to call meetings. The Board should consider whether a provision

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allowing Committee members and the Executive Director to call meetings of a Committee should be created that parallels the Board provision.

We did not see Position Descriptions for Board and Committee officers. While this is not unusual amongst peer funds, it is a leading practice to develop Position Descriptions for Board and Committee officers and even for Board members. The Board should consider whether Position Descriptions would be helpful to new Trustees.

The Bylaws do not provide a process for taking disciplinary action when a Trustee has violated applicable laws or Board policies. Although a Trustee's appointing authority has the ability to remove an appointee at any time, the Board should consider whether adoption of a Board disciplinary policy would be appropriate. If our recommendation that the PEBA Trustees' appointing authorities' right to remove appointees at any time for no reason is repealed, the Board might want to have a process in place to use in the event of misconduct that allows the Board to consider, for example, censure of a Trustee for misbehavior, formally referring a matter to an enforcement authority, revoking Committee appointments or officer positions or taking other disciplinary action.

The Board's Continuing Education Policy contains a process for approval of participation in outside educational programs and reimbursement of expenses upon approval of the Board Chairman. However, we did not see a corresponding approval process for the Board Chairman's own participation in an outside educational program and approval of his travel expenses.

The Board should consider formalizing a process for approval of the Chairman's participation and expenses by another officer, perhaps the Vice Chairman. In addition, the Board should consider formally requiring that participation and costs be reported to the full Board, as well as to the appointing authorities. This would facilitate monitoring of education and ethics policy compliance by co-fiduciaries.

**Recommendation 1.10: The Board should consider further improving its Bylaws and Committee Charters by:**

- **Formalizing the process for development of meeting agendas;**
- **Creating a Charter for the Executive Committee that includes a framework for evaluation of the Executive Director;**
- **Removing the provision that has Committee members serve at the pleasure of the Board Chairman;**
- **Establishing procedures for calling a Committee meeting that parallel those for convening a Board meeting;**

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- **Developing position descriptions for Board and Committee officers;**
- **Creating a Board disciplinary policy;**
- **Formalize a process for approving the Board Chairman's educational program attendance and cost reimbursements;**
- **Including the Board's Self-Assessment process in the Bylaws and using it to identify Trustee training priorities.**

**Conclusion 1.11: Evaluation processes for the Board, Executive Director and staff appear to be adequate and consistent with peer practices. However, as a leading practice, the Board could consider engagement of a third party facilitator to assist with the Board evaluation process.**

The PEBA Executive Director is evaluated through a standard state process conducted by the Agency Head Salary Commission. The PEBA Board prepares a summary of performance and salary recommendations and submits it to the Commission for approval. The Commission consists of four appointees of the chairman of the House Ways and Means Committee, four appointees of the chairman of the Senate Finance Committee, and three appointees of the Governor with experience in executive compensation.

Annually, the PEBA Board chair distributes two forms to collect Board member feedback, one requesting feedback regarding the performance of the Executive Director, and the other a self-assessment questionnaire regarding the performance of the PEBA Board. At the same time, the Executive Director is asked to provide formal feedback of the Board's performance. Board members seemed to generally believe this process has been effective and should be continued.

The Board's use of a self-assessment process is a leading practice that has been adopted by only one of its peers in the FAS benchmark survey. The process appears to be robust and was cited favorably in our interviews. We suggest that the Board consider incorporating the annual board self-assessment process in the Bylaws in order to ensure it becomes a regular discipline that is in place when the Board needs it to address dysfunctions.

We also think the Board should consider improving the process by linking it to the Board's Education Policy. This could be done by developing an inventory of Board skills and comparing it to a Board matrix of desired skills that are needed on the Board. The result could help the Board and Executive Director prioritize training programs and recommend educational opportunities in order to round out the skills set available on the Board. The matrix of desired skills might also be useful to appointing authorities.

Periodic engagement of an outside expert to assist with the self-assessment process should also be considered, as a number of other public pension boards have found that to be valuable.

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However, advice of legal counsel should always be sought in connection with Board self-assessment matters to ensure that confidentiality of evaluations can be maintained. The usefulness of Board evaluations declines when the results become public information.

**Recommendation 1.11: The Board should periodically engage a consultant to facilitate the Board's self-assessment and improvement process, perhaps on a biennial basis.**

### **Board Oversight of the Audit, Risk and Compliance Functions**

**Conclusion 1.12.1: With a permanent Executive Director in place, risk management and compliance oversight functions should be prioritized, and consideration should be given to assigning risk identification and management oversight to a specific committee.**

**Conclusion 1.12.2: Board and Committee oversight of the audit process could be improved through further strengthening of the internal audit function. (See also the text accompanying Conclusion 2.5 for related comments.)**

During PEBA's initial development and organization phase, enhancement of the risk management and compliance functions was in competition with a number of other priorities that were more time sensitive. However, now that a permanent Executive Director is in place and PEBA has begun to prioritize strategic planning, these functions will surface as important concerns that are related to the strategic planning process. Given the array of risks and the range of compliance issues at an organization with PEBA's responsibilities, we think that prioritization of the risk identification and management program and compliance functions are important. We note that PEBA already has advisors and consultants in place that can assist with the process. However, a robust risk management and compliance review might identify areas where additional expertise is needed. The Board should consider where it will assign primary Committee responsibility for oversight of this major project.

**Recommendation 1.12: The Board should proceed with prioritizing enhancement of PEBA's risk identification, risk management and compliance functions. Consideration should be given to the appropriate assignment of Committee oversight responsibilities for this initiative.**

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## **Board Communication Policy**

**Conclusion 1.13: The PEBA Board does not currently have a communication policy. (See Section 4 for additional comments).**

According to our benchmarking survey, most peer agencies do not have a communications policy. However, we did hear comments from several employee and retiree groups that communications with the PEBA Board could be improved.

**Recommendation 1:13: The Board should evaluate mechanisms to improve its two-way communication with stakeholders. (See Conclusion 2.10 and Section 4 for Conclusions on PEBA's Communications Policy and related Recommendations.)**

## **Fiduciary Insurance**

**Conclusion 1.14: PEBA's indemnification policy and fiduciary insurance coverage are consistent with other public pension funds.**

PEBA Trustees are covered by a State statutory indemnity and defense obligation for damages and lawsuits arising out of agency business. Commercial fiduciary liability insurance is also purchased by PEBA for itself and the other trust fund fiduciaries. The current amount of coverage is \$25 million. This is similar to practices of peer funds, where most are also indemnified by statute. However, although only one of its peers purchases fiduciary insurance, PEBA's insurance also covers RSIC and the other co-fiduciaries. Purchase of fiduciary insurance for pension investment agencies is more common. During the Funston RSIC fiduciary audit, we found that half of its peers purchased fiduciary insurance.

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**Table 10 Indemnification**

| <b>Are your trustees indemnified for damages and lawsuits arising from retirement system business; if so, is this required under state statute or through Board policy?</b> |   |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|
| Yes, required under state statutes                                                                                                                                          | 6 |
| Yes, required through Board policy                                                                                                                                          | 1 |
| No, our trustees are not indemnified                                                                                                                                        | 0 |

| <b>Please indicate if you self-insure or purchase commercial Directors' and Officers' insurance.</b> |              |
|------------------------------------------------------------------------------------------------------|--------------|
| We self-insure                                                                                       | 4            |
| We purchase commercial insurance                                                                     | 2            |
| If your agency has indemnification insurance, what is:                                               |              |
| The total amount of coverage                                                                         | \$25 million |
| The deductible amount                                                                                | \$250k;      |
|                                                                                                      | \$1 million  |
| Comment: We self insure through the state risk management pool, to which we pay premiums.            |              |

Highlighted boxes indicates PEBA responses

PEBA's fiduciary insurance coverage is consistent with the other agency in the peer group which also purchased insurance. The \$1 million self-insured retention under PEBA's fiduciary policy is higher than the other agency but within the range for comparable public pension fund investment organizations that was referenced in the RSIC fiduciary audit.

## **2. POLICY REVIEW AND DEVELOPMENT**

### **2.1 Scope of Review**

The policy review and development assessment includes an evaluation for reasonableness and adequacy of PEBA's existing policies and the process of policy development to determine whether PEBA's policies, procedures, practices and functionalities are properly documented, implemented and reflective of the Board of Director's established goals, risk tolerances and governance.

This review addressed the following specific policies:

1. Ethics Policy and enforcement for identifying, disclosing, reporting and mitigating conflicts of interest (to include travel/gift policy and expense reimbursement policy)
2. Valuation Policy
3. Funding Policy
4. Investment Policy
5. Audit Policy
6. Staff Compensation Policy
7. Risk Management Policy
8. Whistleblower Policy
9. Customer Service Policy
10. Communication Policy
11. Procurement Policy
12. Trustee Education Policy
13. Board Expense Reimbursement Policy
14. HIPPA Privacy Policy
15. Claims and Appeals Procedures

### **2.2 Standard for Comparison**

We utilized the experience and expertise of the project team, a new PEBA benchmarking survey commissioned specifically for this review and our public pension governance database to identify where PEBA is consistent with or different from other state public pension benefits administration agencies in these areas. We reviewed all formal policies, as well as policy-related documentation, statutes and memoranda.

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## **2.3 Summary of Policy Review and Development Conclusions**

PEBA's policies are generally robust and incorporate provisions recommended by best practices. PEBA's governing bodies should, however, review its policies and procedures on a regular basis to ensure they remain relevant and compliant. PEBA and its Board have spent much of the past two years in operation establishing the necessary policies and procedures, as well as updating predecessor policies.

***Conclusion 2.1: The Ethics policies by which PEBA is governed are reasonable and adequate and reflects PEBA's commitment to high ethical standards for its Board members and employees.***

***Conclusion 2.2: PEBA complies with the statutory valuation mandates set forth in the South Carolina Code of Laws through its consultative relationship with its actuarial consultant, Gabriel Roeder Smith and Company.***

***Conclusion 2.3: PEBA complies with the statutory funding mandates set forth in the South Carolina Code of Laws.***

***Conclusion 2.4: PEBA assumed oversight of the Deferred Compensation program in January 2014 and the Investment Policy has not yet been reviewed.***

***Conclusion 2.5: PEBA's Board level Audit Policy is consistent with other Board level policies used by other systems.***

***Conclusion 2.6: As a South Carolina State government agency, PEBA is required to adhere to the salary plan designed and regulated by the Human Resources Division of the South Carolina Budget and Control Board.***

***Conclusion 2.7: PEBA does not have a risk management policy that applies to the integrated organization. The risk assessment procedures utilized by the SCRS prior to the merger were a comprehensive internal risk self-assessment tool.***

***Conclusion 2.8: PEBA is subject to the state whistleblower statute and reporting process, therefore, a stand-alone whistleblower policy is not necessary.***

***Conclusion 2.9: PEBA's Customer Service Policy is generally reflected in its Mission/Vision Statement and statement of Core Values.***

***Conclusion 2.10: PEBA does not currently have a communications policy.***

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*Conclusion 2.11: PEBA utilizes the Budget and Control Board's statutorily-required policies for procurement of services; however, its procurement process can be improved.*

*Conclusion 2.12: The Board maintains a continuing education policy, which is integral in developing Board member expertise in upholding fiduciary best practices. However, there are no required topics.*

*Conclusion 2.13: PEBA's Board Travel Reimbursement Policy is adequate and reasonable.*

*Conclusion 2.14: PEBA's HIPPA privacy policies and procedures are adequate and reasonable.*

*Conclusion 2.15: PEBA's claims and appeals procedures are adequate and reasonable.*

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## **2.4 Findings and Recommendations for each Policy Review and Development Conclusion**

### **Ethics Policy**

**Conclusion 2.1: The Ethics policies by which PEBA is governed are reasonable and adequate and reflects PEBA's commitment to high ethical standards for its Board members and employees.**

PEBA Board members and employees are subject to the State Ethics Act, which governs the ethical conduct of South Carolina public officials and public employees. In addition, the Board adopted a supplemental Ethics and Conflicts-of-Interest Policy. The policy provides additional standards of conduct and guidance on conflicts of interest for Board members. We support the Board's efforts in adopting the supplemental Policy, which demonstrates PEBA's commitment to ethical behavior.

Some of the terms used in the supplemental policy, which appears to be based on a model policy used at other funds, are ambiguous, and additional detail may be beneficial for trustees. For example, the policy could further detail who is included in a Board member's "family" for purposes of the policy, and what constitutes a "personal or private commercial or business relationship." Including examples within the policy, and during Board fiduciary training, can also help Board members to fully understand the application of the conduct requirements to their personal situations.

**Recommendation 2.1: To provide the most assistance for Board members in understanding and upholding ethical requirements, the ethics policy should be expanded to provide additional framework around the ethical standards.**

### **Valuation Policy**

**Conclusion 2.2: PEBA complies with the statutory valuation mandates set forth in the South Carolina Code of Laws through its consultative relationship with its actuarial consultant, Gabriel Roeder Smith and Company.**

Title 9 of the South Carolina Code of Laws requires PEBA to engage an actuary to serve as the technical advisor to the Board, to perform an experience study at least once every five years and to make an annual valuation of the contingent assets and liabilities of the Retirement

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System.<sup>1</sup> PEBA contracts with Gabriel Roeder Smith & Company (GRS) for actuarial consulting services. Thus, PEBA complies with the statutory valuation mandates set forth in the South Carolina Code of Laws through its consultative relationship with GRS. GRS also performs actuarial valuations for PEBA's OPEB trust fund.

The overall actuarial services and process provided to and utilized by PEBA appear reasonable and adequate for the retirement, health and disability plans administered by PEBA.

The valuation and funding methodology utilized by GRS on PEBA's behalf is discussed in greater detail in Section 6: Actuarial Matters.

## **Funding Policy**

### **Conclusion 2.3: PEBA complies with the statutory funding mandates set forth in the South Carolina Code of Laws.**

PEBA's funding policy is mandated by statute. Employer and member contribution rates for the Retirement System are determined in accordance with the provisions set forth in Title 9 of the South Carolina Code of Laws.<sup>2</sup> The funding policy set forth in the statute is reasonable and adequate insofar as it provides for the employer and employee contribution rates to be adjusted based on the annual assessment of PEBA's funding status and generally provides for the Retirement System to maintain a funded ratio of at least 90%. The statute, enacted in 2012, sets forth the employer and employee contribution rates for fiscal years 2012-2013, 2013-2014 and 2014-2015.<sup>3</sup> The statute authorizes the Board, after June 30, 2015, to increase the percentage rate in employer and employee contributions on the basis of the actuarial evaluation, subject to an annual increase cap of one-half of 1%.<sup>4</sup>

If the scheduled employer and employee contributions set forth in the statute for fiscal years 2012-2013, 2013-2014 and 2014-2015 are insufficient to maintain a 30-year amortization schedule for the unfunded liabilities of the Retirement System, the statute requires the Board to increase the contribution rates in equal amounts for the employer and employee

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<sup>1</sup> S.C. CODE ANN. §§9-1-240, 9-1-250 and 9-1-260 (Law. Co-op. 1962)

<sup>2</sup> S.C. CODE ANN. §9-1-1085 (Law. Co-op. 2012)

<sup>3</sup> S.C. CODE ANN. §9-1-1085(A) (Law. Co-op. 2012)

<sup>4</sup> S.C. CODE ANN. §9-1-1085(B) (Law. Co-op. 2012)

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contributions as necessary to maintain an amortization schedule of no more than 30 years, notwithstanding the annual increase cap of one-half of 1%.<sup>5</sup>

The statute authorizes the Board, after June 30, 2015, to decrease the percentage rate in employer and employee contributions if the most recent actuarial valuation shows a funded ratio equal to or greater than 90%, if the Board determines that such decrease will not result in a funded ratio of less than 90%.<sup>6</sup> Thus, the statute provides PEBA's Board the flexibility to make adjustments in current and future contribution rates to maintain an adequate funding ratio.

According to GRS's Statement of Certification for the July 1, 2012 actuarial valuation, PEBA's combined funded ratio for all retirement systems under its authority decreased from 67.9% in 2011 to 65.4% in 2012. GRS stated that decreases in PEBA's funded ratio are consistent with its expectations for the next several years as outstanding deferred investment losses become fully recognized in the actuarial value of assets.

### **Investment Policy**

**Conclusion 2.4: PEBA assumed oversight of the Deferred Compensation program in January 2014. The Investment Policy has been reviewed and approved.**

The Board assumed oversight of the Deferred Compensation program on January 1, 2014. The Program's Investment Policy Statement was reviewed by the Retirement Committee and amended by the Board in October 2013 to recognize this transition by noting that the Board would be acting as administrator, trustee and governing body for the program. The Policy is reviewed annually.

### **Audit Policy**

**Conclusion 2.5: PEBA's Board level Audit Policy is consistent with other Board level policies used by other systems.**

PEBA's Finance, Administration, Audit and Compliance Committee Charter consists of the Board's Audit Policy which is updated and adopted on an annual basis. The most recent Audit

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<sup>5</sup> S.C. CODE ANN. §9-1-1085(C) (Law. Co-op. 2012)

<sup>6</sup> S.C. CODE ANN. §9-1-1085(D) (Law. Co-op. 2012)

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Policy was adopted on July 17, 2014. The Audit Policy consists of 1) responsibilities of the Internal Audit Function; 2) coordination and communication between the Board and the Chief Audit Executive; and 3) identified internal audits to be conducted during the course of the year.

Furthermore, Internal Audit's Charter (approved in December of 2013) consists of all core Standards set forth by the Institute of Internal Auditors. These standards consist of the following components are documented either in Internal Audit's Charter or Procedural Manual:

- #1000 – Purpose, Authority and Responsibility
- #1100 – Independence and Objectivity
- #1200 – Proficiency and Due Professional Care
- #1300 – Quality Assurance and Improvement Program
- #2000 – Managing the Internal Audit Activity
- #2100 – Nature of Work
- #2200 – Engagement Planning
- #2300 – Performing the Engagement
- #2400 – Communicating Results
- #2500 – Monitoring Progress
- #2600 – Resolution of Senior Management's Acceptance of Risks

The Internal Audit function consisted of one individual (at the time of FAS' initial fieldwork.; however, an additional employee was hired in November 2014..

PEBA's Internal Audit function conducts and coordinates audits relating to operational, financial and compliance audits, whereas employer insurance audits are conducted within the benefits administration functions.

The Audit Policy calls for a comprehensive risk assessment every five years. Comprehensive risk assessments are more commonly conducted every two or three years to ensure more timely identification of risk issues and priorities.

Staffing levels need to be evaluated based on the maturity level of the organization and the heightened level of risk issues being identified by the Board and PEBA's staff.

**Recommendation 2.5: PEBA should increase the frequency of its enterprise-wide risk assessment. Currently, one is conducted every five years; however, given the significant changes that have occurred in PEBA's leadership, as well as proposed changes, conducting a more frequent risk assessment would help to ensure that new issues or concerns are promptly identified and prioritized for remediation.**

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## **Staff Compensation Policy**

**Conclusion 2.6: As a South Carolina State government agency, PEBA is required to adhere to the salary plan designed and regulated by the Human Resources Division of the South Carolina Budget and Control Board (BCB).**

All PEBA positions are assigned a state job classification which is linked to the appropriate state pay band or salary “range” for the classification. There are ten pay bands, each of which reference a minimum, midpoint and maximum salary.

According to documents provided by PEBA, compensation and position descriptions are evaluated on a regular basis. Most personnel actions generate a review of compensation, such as hiring, requests for pay adjustments, reassignments and position updates. As such, with each such personnel action, a review of the position description is initiated to ensure that the position is appropriately classified. Salary is evaluated in comparison with internal salary data, state government salary data and, when appropriate, private sector salary data.

PEBA utilizes BCB Employee Performance Management System Policy and Procedure for salary increases. The BCB Employee Performance Management System Policy and Procedure provides a formal and structured method for evaluation and rating of employees’ job performance, which serves as a basis and justification for the award of the salary increase. PEBA also complies with the South Carolina Human Resources Regulations in terms of the range of compensation and salary increases.

The fact that PEBA positions and compensation for those positions are tied to the State job classification and compensation framework is generally consistent with peer funds.

**Recommendation 2.6: PEBA should have a formal compensation policy which documents its acknowledgement of its status as a South Carolina State government agency and its compliance with the State’s Office of Human Resources policies, job classifications system and pay bands. A simple statement and reference to the State policies to which it adheres would provide transparency of PEBA’s compensation policy to its employees and to the public.**

## **Risk Management Policy**

**Conclusion 2.7: PEBA does not have a risk management policy that applies to the integrated organization. The risk assessment procedures utilized by the SCRS prior to the merger were a comprehensive internal risk self-assessment tool.**

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The last comprehensive risk assessment was completed on July 14, 2010, which predated the merger of SCRS and EIP. As such, the risk assessment applied only to SCRS. Prior to that, SCRS completed a Management Risk Assessment questionnaire issued by the Office of Internal Audit Services division of the State's Budget and Control Board, in May 2009.

Since the merger, PEBA's Internal Audit Department has been developing a comprehensive risk assessment for the integrated organization that is based upon the Committee of Sponsoring Organizations of the Treadway Commission (COSO) model.

In August 2013, Deloitte & Touche performed an Information Security Risk Assessment on PEBA's Information Security function.

**Recommendation 2.7.1: Internal Audit should continue to develop a comprehensive risk self-assessment tool for PEBA as an integrated organization.**

**Recommendation 2.7.2: The development of a risk management policy (including risk appetite and risk tolerance) should be the responsibility of executive management with input from Internal Audit and other stakeholders.**

**Recommendation 2.7.3: An executive should be assigned responsibility and accountability for the assessment and management of specific risks within each business function and overall based on factors such as impact, velocity and vulnerability. Internal Audit and others can support management in their self-assessments but operating management should be held accountable for the results.**

**Recommendation 2.7.4: The Board should identify the type and magnitude of risks which ought to come to its attention, e.g., financial, legal, operational, organizational, reputational, strategic.**

**Recommendation 2.7.5: The Board should require that the presentation of information for all major decisions include a risk assessment including the risk of inaction.**

**Recommendation 2.7.6: Internal Audit should focus its audit plans on areas that present the highest inherent risk and which rely most of the effectiveness of controls. Time permitting; Internal Audit should focus its consulting efforts on areas of high inherent risk and low control effectiveness.**

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## **Whistleblower Policy**

**Conclusion 2.8: PEBA is subject to the State’s whistleblower statute and reporting process; therefore, a stand-alone whistleblower policy is not necessary.**

PEBA is subject to the State’s whistleblower policy, which is set forth in Title 8 of South Carolina Code of Laws. In addition, PEBA publicizes the State's Fraud Reporting Hotline on its websites and provides the contact information a link to the Office of the State Inspector General’s website.

## **Customer Service Policy**

**Conclusion 2.9: PEBA’s Customer Service Policy is generally reflected in its draft Strategic Plan for 2014-15.**

In response to our request for PEBA’s Customer Service Policy, we were referred to Part I of PEBA’s draft Strategic Plan for 2014-15, which sets forth PEBA’s Mission/Vision Statement and Core Values. “Quality Customer Services and Products” is listed as one of PEBA’s Core Values, which states, in relevant part, “We consistently provide outstanding products and excellent customer services, as defined by our customers, and we strive for continuous improvement. Our interaction with customers is fair, fast, simple, and comprehensible.” It is typical and appropriate for an organization to have a Mission Statement and identify certain values by which it operates.

Interviews with directors of the employee and retiree organizations demonstrated a high degree of satisfaction with PEBA’s service. Call Center survey results likewise indicate a high degree of customer satisfaction, as did interviews with the PEBA-participating employers.

CEM’s benchmarking analysis provided some insight into the level of PEBA’s customer service in comparison to its peers. It should be noted, however, that CEM utilizes a data-driven metric that does not assess actual approval PEBA’s customers have expressed in PEBA-initiated surveys. In any event, it would be useful to consider the conclusions reached by CEM in its analysis.

Documentation provided by PEBA indicates PEBA monitors the quality of its customer service by way of surveys given to stakeholders (active and retired members, beneficiaries, inactive members, and employers). The Call Center generates year-long survey with questions that assess the timeliness, courtesy and adequacy of the interaction from the caller’s perspective. In addition, PEBA generates an annual customer satisfaction survey to stakeholders.

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## **Communication Policy**

### **Conclusion 2.10: PEBA does not currently have a communications policy.**

PEBA does not currently have a communications policy. A communications policy could be beneficial in outlining Board member communications with each other, staff members, vendors, potential vendors and other external parties. Recommendations regarding a communications policy for PEBA will be discussed in greater detail in Section 4: Content and Form of Communications with Stakeholders.

## **Procurement Policy**

### **Conclusion 2.11: PEBA utilizes the Budget and Control Board's statutorily-required policies for procurement of services; however, its procurement process can be improved.**

PEBA uses the Budget and Control Board (BCB) Policies for procurement of services. Services that have unique characteristic (such as unique types of services, technical competency or independence, etc.) utilize the BCB's single source guidelines and requisition procedures.

Until recently, there was an unfilled procurement position and no single PEBA procurement staff or coordinator. PEBA's staff worked any significant procurement requests through the Executive Director, Legal and BCB's procurement liaison to identify vendors, issue requests for proposals, evaluate bids and execute contracts and monitor the quality of service delivery.

PEBA has encountered recent challenges in the procurement of certain large contracts relating to pharmaceutical and healthcare provider benefits. PEBA recently hired an experienced procurement manager; however, it is not clear if there will be adequate staff resources with significant contracting experience to effectively address the five major procurements anticipated over the next two years.

PEBA's Internal Audit function has not had a formal schedule for evaluating the procurement process. However, Internal Audit has identified this as an item that could be added to the audit schedule.

Procurement of certain services, such as external financial audits, are determined and coordinated through the Office of the State Auditor.

### **Recommendation 2.11.1: PEBA should determine whether it needs additional experienced procurement resources to address upcoming requirements.**

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**Recommendation 2.11.2: PEBA should consider revising its procurement process to provide for a post-audit process by Internal Audit, potentially using a questionnaire.**

## **Trustee Education Policy**

**Conclusion 2.12: The Board maintains a continuing education policy, which is integral in developing Board member expertise in upholding fiduciary best practices. However, there are no required topics.**

The Board maintains a continuing education policy, which is integral in developing Board member expertise necessary in upholding fiduciary best practices. The policy requires 18 hours of educational training every two years, but 12 of those credits appear to be available through attendance at the Board's annual retreat. The policy does not specify any specific topics to be covered by the training.

It is important that Trustees receive some independent training that is separate from sessions developed or overseen by staff. This helps to expose Trustees to new ideas and avoid the potential for "group think."

As noted in Recommendation 1.8, training regarding fiduciary duties for new trustees and periodic updates for all trustees is appropriate and a leading practice. Trustee training priorities could also be informed by the Board self-assessment process (see Recommendation 1.11.)

**Recommendation 2.12.1: With most Board members only needing six additional credits after attending the Board's annual retreat, the Board should determine whether the Board members are receiving sufficient training from independent outside sources. If not, the policy should be revised to require additional credits or limit the number of credits from the Board retreat and staff training that can be used to meet training requirements.**

**Recommendation 2.12.2: The PEBA Trustee Education Policy should specify topics on which training is needed and include mandatory fiduciary training on a periodic basis, and could be linked with the self-assessment process.**

## **Board Expense Reimbursement Policy**

**Conclusion 2.13: PEBA's Board Travel Reimbursement Policy is adequate and reasonable.**

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The Board's Travel Policy states that travel should be for the purpose of fulfilling continuing education requirements or performing due diligence when necessary. Pursuant to the Board's Reimbursement Policy, the Chairman must approve all travel reimbursements. Board member involvement in due diligence as well as other PEBA-related business can be beneficial for the Board and PEBA. Accordingly, the Chairman should continue to approve travel for PEBA purposes when it is appropriate and beneficial, even if it is not related to continuing education. (See also Recommendation 1.10 regarding addition of a provision relating to approval of the Chairman's travel and expenditures.)

### **HIPPA Privacy Policy**

**Conclusion 2.14: PEBA's HIPPA privacy policies and procedures are adequate and reasonable.**

The HIPAA Privacy and Security policies detail processes and procedures that will aid in PEBA's compliance with HIPAA requirements. They were reviewed and updated in September 2014, integrating the most recent regulatory requirements. PEBA's compliance with HIPPA will be discussed in greater detail in Section 7: Legal Compliance.

### **Claims and Appeals Procedures**

**Conclusion 2.15: PEBA's claims and appeals procedures are adequate and reasonable.**

PEBA's claims and appeals procedures are extensive and provide a number of layers of review for retirement and health claims. The process appears to be effective, as the Administrative Law Court has agreed with PEBA's determination in a de novo review of all cases that we reviewed.

## **3. ORGANIZATIONAL STRUCTURE**

### **3.1 Scope of Review**

The organizational structure assessment included an evaluation for reasonableness and adequacy of PEBA's current organizational structure as it relates to PEBA's administration of the State Employee Insurance Program, the Retirement System's benefits administration, deferred compensation program and other state employee benefit programs under its authority. The assessment focused on ascertaining whether there is a need for clarification and/or additional specifications of the respective roles and responsibilities of the Board of Directors and PEBA staff.

The assessment addressed the following specific topics:

#### **A. People/Organization**

1. Roles and responsibilities of key staff
2. Staff position description review
3. Number, type skill sets, and credentials of staff
4. Training of staff and education policies
5. Cross-training and succession planning
6. Alternative organizational designs

#### **B. Reporting Lines and Board Reporting**

7. Reporting lines, spans of control and segregation of duties (including internal controls)
8. Adequacy of reporting and disclosure from staff to Board to facilitate oversight

#### **C. Policies and Process**

9. Standard operating procedures manual

#### **D. Systems/Infrastructure**

10. Adequacy of tools and resources, including IT infrastructure

#### **E. The Memorandum of Understanding with RSIC**

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### **3.2 Standard for Comparison**

We conducted interviews with PEBA Board members; members of PEBA's executive staff and directors, including the Executive Director, the Chief Operating Officer (COO), the Internal Auditor, the Director of Retirement Systems Finance, the Director of Employee Insurance Program Finance, Director of Administration. We reviewed key documents, including PEBA's organizational chart, utilized a new PEBA benchmarking survey commissioned specifically for this review and the FAS public pension governance database for a comparison of PEBA's practices with peer funds, in addition to our review team's experience.

### **3.3 Summary of Organization Structure Conclusions**

*Conclusion 3.1: The roles and responsibilities of key staff are clearly defined. The recent reorganization of the executive staff should improve leadership and communications; more clearly balance and define responsibilities; and provide for better succession planning. Furthermore, the creation of an executive position over PEBA's insurance function is a significant improvement.*

*Conclusion 3.2: PEBA maintains position descriptions for executive staff and management, as well as for staff in classified positions.*

*Conclusion 3.3: Our review revealed no organizational deficiencies in the qualifications of PEBA staff members to perform assigned duties. Until recently, there had been significant understaffing at PEBA due to vacated positions not being filled.*

*Conclusion 3.4: There does not appear to be a formal training program or policy for staff in most PEBA departments.*

*Conclusion 3.5: There does not appear to be a formal cross training and succession planning policy or program.*

*Conclusion 3.6: Future organizational developments could focus on additional integration of retirement and insurance functions where possible.*

*Conclusion 3.7: Until the recent reorganization, PEBA's organizational structure required staff with overlapping responsibilities to report to Board subcommittees. Reporting was streamlined under the new organizational structure.*

*Conclusion 3.8: Some, but not all, of PEBA's departments have written operating policies and procedures.*

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*Conclusion 3.9: Our review revealed no deficiencies with regard to tools and resources available to PEBA staff to perform assigned functions.*

*Conclusion 3.10: The Memorandum of Understanding between PEBA and the South Carolina Retirement System Investment Commission adequately sets forth the relationship between and obligations of the two entities to provide support to each other in fulfillment of their respective statutory mandates and functions.*

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### **3.4 Findings and Recommendations for each Organizational Structure**

#### **Conclusion**

#### **Background**

PEBA is governed by an 11-member Board. The organization itself is staffed by an approved complement of total of 270 employees, led by an Executive Director who reports directly to the Board. The executive staff, who assist the Executive Director in running the day-to-day operations of PEBA, is comprised of the Chief Operating Officer, the Internal Auditor, the General Counsel, the Director of Retirement Systems Finance and the Director of Employee Insurance Program Finance. In addition to reporting to the Executive Director, the Internal Auditor also reports directly to the Board.

Each executive staff member oversees one or more PEBA departments. The General Counsel oversees the Legal Department; the Director of Retirement Systems Finance oversees the accounting operations for the PEBA's benefits and investment functions; the Director of Employee Insurance Finance oversees the accounting operations for PEBA's insurance function; the Internal Auditor oversees PEBA's internal audit and risk control functions; and the Chief Operating Officer oversees PEBA's Human Resources department, Administration/Budget, Information Technology, Actuarial, Customer Service and Contracts/Procurement.

At the level beneath the executive staff are the directors of the various PEBA departments. At the departmental level, program managers lead units, many of which contain mid-level supervisory staff.

Since the July 1, 2012 merger of the South Carolina Retirement Systems and the Employee Insurance Program, staff have integrated services for the two benefit programs, previously done by two separate entities, into one organization. This integration is not yet complete and will require a certain degree of restructuring to optimize efficiencies and staff expertise in all functions.

#### **People / Organization**

##### **Roles and responsibilities of key staff**

**Conclusion 3.1: The roles and responsibilities of key staff are clearly defined. The recent reorganization of the executive staff should improve leadership and communications; more**

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**clearly balance and define responsibilities; and provide for better succession planning. Furthermore, the creation of an executive position over PEBA's insurance function is a significant improvement.**

Prior to the reorganization announced in early December 2014, there were a number of organizational issues the review team identified and discussed with the new Executive Director. Among the issues at that time were:

- Lack of a clear leader of insurance operations
- Lack of a single leader of finance, budgeting and reporting
- PEBA had not integrated the employer services function
- The need for a capability to support development of new processes and information systems requirements while maintaining current systems and service levels
- Lack of apparent executive development paths for succession planning purposes

The new organization in place since December 2, 2014 was designed to address these issues and, in our opinion, is a significant step forward organizationally.

Ideally, there should be one PEBA executive position overseeing the Retirement program, such as a Retirement Benefits Director, and a separate executive position overseeing the Insurance program, such as an Insurance Program Director. The lack of an insurance leader was the more significant issue; an Insurance Program Director could lead the development of strategic planning and implementation with the objective of improving the insurance plan over the long term. It would also be appropriate to have a manager of all the Deferred Compensation (DC) Plans to report directly to the Retirement Benefits Director to ensure the DC plans receive appropriate visibility and attention.

The recent organizational change created the position of Health Care Policy Director. While this position remains to be filled, it is an important step to developing a more strategic health policy staff and capability within PEBA.

Similarly, PEBA did not have a Chief Financial Officer to oversee all of PEBA's financial functions and processes. PEBA's Budget and Facilities function was overseen by the Director of Administration. The recent reorganization created a Chief Financial Officer position, which is filled, and budgeting and facilities is more appropriately overseen by a departmental manager under the Chief Financial Officer.

Under the COO, there is now a new Employer Services Director position which will be charged with developing the future strategy and vision for servicing all PEBA employers in the most effective and efficient manner.

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With respect to major IT projects involving redesign of the business operations, an Operational Research and Development Department was created to lead projects that have an enterprise-wide focus. The office will be led by a trained project manager and have access to staff that are business process improvement specialists.

Currently, PEBA's Chief Operating Officer oversees six PEBA departments, including Human Resources, Information Technology, Operational Research and Development, Communications, Customer Service and Employer Services. As the Chief Operating Officer is directly responsible for the day-to-day operations of the largest part of PEBA's retirement programs and services, as well as support and administration, her level of responsibility is second only to the Executive Director's. As such, her position is also akin to a Deputy Executive Director. Although there may be some reluctance to add the title of Deputy Executive Director to the Chief Operating Officer, doing so could provide a mechanism for a succession plan for the Executive Director position.

The organizational changes recently implemented are significant steps in the direction of a more professional and modernized leadership structure for PEBA. By implementing these changes PEBA not only enhanced the effective management of its core functions and streamlined communication flow to the Executive Director, it has established a solid foundation for the management and administration of future initiatives and improvements.

**Recommendation 3.1.1: PEBA should consider adding the title of Deputy Executive Director to the title of Chief Operating Officer to provide a more streamlined flow of communication between the Executive Director and executive staff, as well as create a succession plan for the Executive Director position.**

**Recommendation 3.1.2: Over the longer term, PEBA should consider creating the position of a leader of retirement programs who would have responsibility for both defined benefit and defined contribution and savings programs.**

### **Staff position description review**

**Conclusion 3.2: PEBA maintains position descriptions for executive staff and management, as well as for staff in classified positions.**

PEBA maintains position descriptions for executive staff and management (unclassified) positions, which appear to be adequate and detailed. The roles and responsibilities of executive staff and management positions are set forth in the position description documents.

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PEBA states it also maintains written position descriptions for staff (classified) positions below the management level, which are maintained in each employee's personnel file. PEBA further states that most personnel actions generate a review of compensation, such as hiring, requests for pay adjustments, reassignments and position updates. [See Section 2: Policy Review and Development].

### **Number, type, skill sets, and credentials of staff**

**Conclusion 3.3: Our review revealed no organizational deficiencies in the qualifications of PEBA staff members to perform assigned duties. Until recently, there had been significant understaffing at PEBA due to vacated positions not being filled.**

PEBA has had significant understaffing due to approved positions not being filled. PEBA is beginning to remedy this and has filled all but about 12 positions as of the November 2014 timeframe. At one point, there were 36 vacancies. PEBA should pay particular attention to areas with positions currently filled by Teachers and Employee Retention Retired (TERI) program participants, as the TERI program will be closed effective June 30, 2018.

Our review revealed no deficiencies in qualifications of staff to perform assigned duties.

**Recommendation 3.3: PEBA should continue to fill remaining vacant positions in order to maintain sufficient staffing in all areas to effectively and efficiently perform all functions.**

### **Training of staff and education policies**

**Conclusion 3.4: There does not appear to be a formal training program or policy for staff in most PEBA departments.**

PEBA conducted a workforce planning initiative as an outcome of its 2013 strategic planning process. The process was used to identify gaps in the workforce and succession concerns. As a result of this process, PEBA established and filled many positions to improve depth of professional level staff and identify areas where cross-training could assist in developing pools of more qualified candidates. In addition, several knowledge-sharing initiatives were implemented in a couple of areas.

While there are some useful initiatives to build upon, there has not been a formal training and education program beyond those found in the Call Center and Visitor Intake. This is an opportunity area as PEBA builds its capabilities for the future.

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**Recommendation 3.4.1:** Each PEBA business area should develop a specialized staff training and education policy and program for staff in their area.

**Recommendation 3.4.2:** Human resources should develop a training policy and program that provides for new employee orientation. New Employee Orientation should include a general organizational overview of PEBA's functions and services.

### **Cross-training and succession planning**

**Conclusion 3.5:** There does not appear to be a formal cross training and succession planning policy or program.

Although PEBA does not have an agency-wide cross-training program, there is a formal cross-training program in two of the largest operational areas – the Call Center and Visitor Intake. Employees in these areas are cross-trained on insurance and retirement. This was a major initiative after the creation of PEBA and it appears to have provided a more efficient and responsive customer service experience. This cross-training program also provided an additional step and salary increase in the Call Center's career path.

On a smaller scale, PEBA recently completed cross-training in Retirement Systems Imaging and Enrollment. Although very much alike and dependent upon one another, these departments were segregated. Employees have now cross-trained and function as one department. This was intended to assist in the upcoming operational improvements and to be a preemptive action in preparation for a possible overstaffed department as automation technologies improve.

**Recommendation 3.5.1:** The staff training and education policy should provide for cross-training and rotation of staff to other, similarly classified positions within the business functions for cross-training purposes.

**Recommendation 3.5.2:** Succession planning should be a higher priority. Executive Staff and managers should maintain organizational charts of each business unit that reflect the time remaining to retirement eligibility of individual staff members and regularly discuss anticipated vacancies and plan for future staffing needs and training. The discussion should also include the possibility of back-filling positions where vacancies are anticipated to provide that the replacement is fully trained when the retiring staff member vacates the position.

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## **Alternative organizational designs**

**Conclusion 3.6: Future organizational developments could focus on additional integration of retirement and insurance functions where possible.**

The organizational structure below the executive management level, while partially integrated since the creation of PEBA, needs further integration and consolidation of functions. The Employee Insurance Program Finance area remains roughly the same as it was under the previous Employee Insurance Plan (EIP) and has not been fully integrated. Customer service functions are not fully integrated, although there have been continuing efforts to have a single point of contact for customers. The budgeting process does not appear to have been linked to an overall business planning process.

**Recommendation 3.6.1: As the new technology platform and processes are developed, PEBA should implement additional operational consolidations.**

**Recommendation 3.6.2: The budgeting process for all areas should be more coordinated and collaborative. A formal budget process should be developed and include all department heads in its development. Integration of the budget process will reduce silos and enhance an enterprise approach to administrative functions.**

## **Reporting Lines and Reporting to the Board**

### **Adequacy of reporting and disclosure from staff to Board to facilitate oversight**

**Conclusion 3.7: Until the recent reorganization, PEBA's organizational structure required staff with overlapping responsibilities to report to Board subcommittees. Reporting was streamlined under the new organizational structure.**

The former organizational structure required multiple reports to the Retirement and Health Committees instead of having executive level staff reporting to each of the committees. This resulted in several staff reporting on different aspects of each division. The one remaining example of this is that for the retirement program, the manager of the deferred compensation plans and the ORP reports to the Retirement Committee in addition to the new Chief Financial Officer.

The same was true of the insurance program; there were two separate divisions, one focusing on policy and the other focusing on insurance finance. As the finance areas of insurance and retirement were combined and are now overseen by a Chief Financial Officer, and the health

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policy/strategy function was combined into one division and overseen by a Healthcare Policy Director, these issues appear to be resolved.

Under the new structure, the Chief Financial Officer will report on the financing aspect of both the retirement and insurance programs, and the Healthcare Policy Director will report on the health policy and strategy aspect of the insurance program. This should result in more focused reporting to the Committees and allow the Committee members to better evaluate these key components of each program.

## **Policies and Process**

### **Standard operating procedures manual**

**Conclusion 3.8: Some, but not all, of PEBA's departments have written operating policies and procedures.**

Leading industry practices include maintaining a standard operating procedures manual describing each department's or unit's procedures for performing its functions. For example, PEBA's benefits administration procedures are comprehensive and well-documented, but this is not the case in most other functions.

Having consistent written policies and procedures for all functions would be helpful not only with staff training, but also assisting with the internal auditing and review of procedures. Periodic review of written procedures can help to identify gaps and inefficiencies. Written operating procedures manuals could be shared between departments when processes overlap so that each affected unit is aware of the responsibilities of the other unit.

**Recommendation 3.8: Each of PEBA's departments should create and maintain a standard operating procedures manual documenting its process for performing its functions.**

## **Systems / Infrastructure**

### **Adequacy of tools and resources, including IT infrastructure**

**Conclusion 3.9: Our review revealed no deficiencies with regard to tools and resources available to PEBA staff to perform assigned functions.**

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PEBA staff appear to have adequate tools and resources necessary to perform their duties and carry out their departmental functions. Interviews with PEBA managers and staff did indicate, however, a deficiency in staffing in certain areas since the merger, which, as discussed above, is in the process of being remedied.

Although PEBA's current information technology infrastructure is adequate, it is unlikely that the system will be sustainable in the long term, and will require a significant upgrade and integration of key systems. PEBA's information technology systems will be discussed in greater detail in Section 11: Information Technology Systems.

### **The Memorandum of Understanding with RSIC**

**Conclusion 3.10: The Memorandum of Understanding between PEBA and the South Carolina Retirement System Investment Commission adequately sets forth the relationship between and obligations of the two entities to provide support to each other in fulfillment of their respective statutory mandates and functions.**

## **4. CONTENT AND FORM OF COMMUNICATIONS WITH STAKEHOLDERS**

### **4.1 Scope of Review**

We evaluated the reasonableness and adequacy of PEBA's form and content of communication, reporting, and disclosures with its stakeholders and participants. The review addressed the following specific topics:

1. Website content
2. Active members
3. Inactive members
4. Retirees and survivors
5. Personnel and payroll offices
6. Plan sponsor decision-makers
7. General public
8. Oversight committees (if they exist)
9. Legislators

### **4.2 Standard for Comparison**

We conducted interviews with numerous internal PEBA staff as well as key external stakeholders, including leaders of a retiree group, five employee groups, four employers, and an advisory panel, as well as state Senate staff. We also reviewed many communications-related documents including newsletters, plan documents, member surveys, and press releases. Our analysis also included benchmarking data from three sources: a custom PEBA benchmarking survey of other pension administration agencies conducted by FAS for this review; the 2013 CEM Defined Benefit Administration benchmarking Study; and the FAS public pension governance database.

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### **4.3 Summary of Communications Conclusions**

*Conclusion 4.1: PEBA has an effective Communications Department, but overall planning and coordination could be improved.*

*Conclusion 4.2: Although the three PEBA websites in use are comprehensive in the information they provide, navigation among the three sites is challenging and self-service functions are limited.*

*Conclusion 4.3: PEBA communications to active members is cost-effective through extensive use of digital media and appears to be effective; however, some improvements could be considered.*

*Conclusion 4.4: PEBA does not have an active communications approach with inactive members but the PEBA website does provide a tool for inactive members to check their accounts online.*

*Conclusion 4.5: PEBA communications to retirees and survivors is cost-effective through extensive use of digital media and appears to be effective; however, some improvements could be considered.*

*Conclusion 4.6: PEBA communications with employer personnel and payroll offices appears to be effective; there are some opportunities for improvement.*

*Conclusion 4.7: Opportunities for plan sponsor decision-makers to obtain information regarding PEBA appear to be adequate.*

*Conclusion 4.8: PEBA's communications to the public meet statutory requirements and the PEBA website makes an extensive range of information available.*

*Conclusion 4.9: The Retirement and Pre-Retirement Advisory Panel previously had an important advisory role to the BCB but appears to now be somewhat redundant with the PEBA Board of Directors.*

*Conclusion 4.10: PEBA's communications to the Budget and Control Board meet statutory requirements.*

*Conclusion 4.11: PEBA's communications to the General Assembly meet statutory requirements; however, there are opportunities to better engage with legislators to advocate for PEBA's needs.*

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## **4.4 Findings and Recommendations for each Communications Conclusion**

### **Background**

The PEBA Communications Department consists of seven full-time staff members and now reports to the COO (prior to the recent reorganization Communications was part of the Customer Services Department). Communications is responsible for maintaining the PEBA websites, producing publications and managing social media activities. In addition to these services, the department also monitors external and internal events and advises the call center and member intake areas when they should expect to be affected. When PEBA receives a Freedom of Information Act (FOIA) request, typically 20-25 times annually, Communications acknowledges receipt immediately, coordinates with Legal, and provides the final response.

Many of the communications materials and activities related to insurance are coordinated to support the annual enrollment cycle, with members receiving information in September to support the open enrollment period in October. On the other hand, most of the recurring retirement-related publications, such as annual reports, are produced or updated on a fiscal year basis, with the fiscal yearend occurring on June 30.

PEBA has developed a communications matrix which identifies all the communications vehicles, i.e., websites; social media; RSS feeds; presentations and videos; publications; and other, and maps specific items in each category into different target audiences, i.e., General Stakeholders; Covered Employers; Actives; Retirees; Inactives or COBRAS/Survivors; and Employees. The communications matrix lists items 1) in production and currently available; 2) items in development; and 3) items in concept phase or early planning stages.

The communications matrix is a comprehensive document which contains a listing of not only all existing communications materials, but also a significant range of new ideas for future development and implementation. Among the plans currently under development are:

- A new, consolidated PEBA website planned for 3Q 2015 rollout with expanded self-service functions
- A basic financial education series
- New digital media approaches, including support for e-readers, use of QR codes, and infographics
- A mobile retirement benefits website (already exists for insurance)

Among the longer-term items being considered, but not yet approved, are:

- New social media channels and accounts in Instagram, YouTube, Vimeo and Pinterest
- A PEBA smartphone application

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- New blog or chat approaches with the Executive Director and/or Board members
- Redevelopment of employer training approach and materials
- Expanded use of webinars for member education

In addition to staff in the Communications Department, the new Executive Director has taken initial steps to increase communications with members and retirees, sometimes together with the Executive Director of the Retirement System Investment Commission, which is a positive step.

Based upon our interviews with PEBA Board members and employee and retiree groups, the PEBA Board members do not seem to actively communicate with employees or retirees beyond responding to the occasional inquiry. With the exception of several representative members, the Board members state that they do not see communications with stakeholders to be a key responsibility for the Board.

In our Retirement Administration Agency Peer Benchmarking study, we obtained feedback regarding trustee, executive and staff interactions with member, retiree, and employer groups and received the following results. PEBA's responses are shaded in green.

**Table 11 Communication Matrix**

| Who regularly meets with or otherwise communicates with members, retiree groups, and employers and how often does this occur?                                                                                                                                                                                                                                                                                                                                                           | Trustees |          |                    |                   | Agency Executives |          |                    |                   | Agency Staff |          |                    |                   |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|--------------------|-------------------|-------------------|----------|--------------------|-------------------|--------------|----------|--------------------|-------------------|
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Rarely   | Annually | 2-3 times per year | Quarterly or more | Rarely            | Annually | 2-3 times per year | Quarterly or more | Rarely       | Annually | 2-3 times per year | Quarterly or more |
| Members                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |          |          |                    |                   |                   |          |                    | 2                 |              | 1        |                    | 4                 |
| Retirees                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |          |          |                    |                   |                   | 1        |                    | 2                 |              | 1        |                    | 3                 |
| Employers                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |          |          |                    |                   |                   |          | 1                  | 2                 | 1            | 1        |                    | 3                 |
| Comment: Retirement Systems' staff conducts Retirement Planning Conferences for Actives and Employer Training for participating employers across the state throughout the year.                                                                                                                                                                                                                                                                                                         |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |
| Comment: Board meetings are open and members, retirees and employers often attend. Staff regularly meet with all constituent groups.                                                                                                                                                                                                                                                                                                                                                    |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |
| Comment: Staff meet with members along with providing on-site and off-site group counseling sessions, participate in retiree events during the year, and regularly work with the employer in resolving business issues. Agency Executives regularly work with employers to resolve business and benefit issues, present before member and retiree groups. Trustees, particularly those elected by their respective participants, regularly field contacts from participants and unions. |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |

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As indicated in the peer responses, the lack of involvement by PEBA's trustees is not unusual. However, there is an opportunity for Board members to play an important role in stakeholder communications and engagement which is critical for a retirement agency in fulfilling its mission.

### **Conclusion 4.1: PEBA has an effective Communications Department, but overall planning and coordination could be improved.**

Although PEBA has developed a communications matrix which appropriately identifies key target audiences and maps various communications channels and materials into each audience, there does not appear to be an overall PEBA communications strategy which also includes communications objectives, messages, and metrics; organizational responsibilities; key initiatives; and budget requirements.

FAS surveyed peer retirement administration agencies about their communications plans and received the following results. PEBA's response is indicated by the green shading.

**Table 12 Communications Plan**

| Does your system have a documented communications plan?         | N = 7 |
|-----------------------------------------------------------------|-------|
| Yes, developed, approved and monitored by the Board             | 0     |
| Yes, developed by staff and approved and monitored by the Board | 1     |
| Yes, developed, approved and monitored by the staff             | 1     |
| No, we do not have a documented communications plan             | 5     |

| If you have a communications plan, does it include strategies for communications with:                | N = 2 |
|-------------------------------------------------------------------------------------------------------|-------|
| Retirees                                                                                              | 2     |
| Active members                                                                                        | 2     |
| Inactive members                                                                                      | 1     |
| Retiree groups                                                                                        | 1     |
| Employer groups                                                                                       | 2     |
| Legislators                                                                                           | 0     |
| Bodies or individuals who appoint Board members                                                       | 0     |
| Oversight committee (if applicable)                                                                   | 0     |
| Media                                                                                                 | 1     |
| Comment: Although we do not have a documented policy/plan, we do have strategies for much of the list |       |

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Although it is not prevailing practice, we believe leading practice is to develop a strategic communications plan helps define communications objectives, identify target stakeholder groups, clarify responsibilities, and prioritize improvement efforts.

**Recommendation 4.1: PEBA should develop a comprehensive communications strategy and plan.**

### **Website content**

**Conclusion 4.2: Although the three PEBA websites in use are comprehensive in the information they provide, navigation among the three sites is challenging and self-service functions are limited.**

### **The PEBA website**

After the formation of PEBA in 2012, a new PEBA website was developed which linked to the two old websites of the South Carolina Retirement System and the Employee Insurance Division. The PEBA website includes an overview of PEBA and news updates, information concerning the PEBA Board of Directors and meetings, a biography of the Executive Director, HIPPA information, and general PEBA contact information. All other information remains on the two original retirement and insurance websites which are available by clicking through the main PEBA home page. We understand an all-new, consolidated PEBA website is under development and planned for launch during the second half of 2015.

### **The Retirement website**

The retirement website is comprehensive in providing information to members, retirees and employers as well as the general public. Detailed plan information and brochures are available electronically for all five defined-benefit plans as well as the Optional State Retirement System and the Deferred Compensation Program.

Active members can view and update their personal information online. All forms are available online but must be printed and physically submitted; online form submission is not available. Many forms have been automated in an effort to eventually eliminate the form. For example, annuitant payees can change their direct deposit and tax withholding through the secure Member Access system or alternatively, they can submit a paper form. Member Access is a secure area separate from the Retiree Resource Center.

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A video library available on demand provides plan overviews as well as assistance in selecting a retirement plan and explaining average final compensation. Members also have access to pre-retirement planning materials and benefits calculators. There is also a New Employee Resource Center to assist new employees in understanding their retirement benefits and making retirement plan selections.

In each defined benefit plan, inactive members can look up their account through either their social security number or name and date of birth.

The Retiree Resource Center provides information, forms, and publication for retirees. It includes information on payment dates, adjustments, death benefits, beneficiary changes and taxes. Changes of address can be updated online through the retiree account.

The PEBA Employer Resource Center makes available the information, forms, and employer training necessary for employers to provide the administration of retirement benefits, including a detailed employer manual, contribution rates and guidance on complying with GASB reporting requirements and how to obtain assistance. An employer newsfeed is available as a syndicated RSS subscription. Planned employer training dates around the state are available and employers can download and print all training materials.

### **The Insurance website**

The insurance website provides a broad range of information and forms which cover the many programs offered by PEBA including health insurance, dental insurance, vision care, life insurance, long-term disability (LTD), and MoneyPlus health savings accounts. Forms for insurance elections, HIPPA, COBRA coverages, and a variety of other situations are all available on the site. Coverage and eligibility information for Active Employees, COBRA Subscribers, Retirees, Survivors, Spouses and Children, and Local Subdivisions is available. Plan descriptions, premium information, and related brochures are available for all programs offered by PEBA. Open enrollment and other training and education presentations are available for downloading. The website explains the Tobacco Program and provides related forms and information.

The Prevention Partners portion of the Insurance website includes an overview of the program and numerous pages of detail, including a description of wellness and prevention benefits, workplace screenings information, a training calendar, and newsletters. There is also a section for employer benefits administrators to obtain information and log in.

The MyBenefits site allows subscribers to review benefits, change contact information or beneficiaries online, and print a benefit statement, as well as obtain their Benefits Identification

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Number (BIN). During the annual enrollment period, subscribers can make their own changes using MyBenefits, and throughout the year Benefits Administrators can process special eligibility changes or new hires using Employee Benefits. For claims information, the website contains links to each of the insurance programs through the carrier websites.

**Recommendation 4.2.1: PEBA should develop the planned consolidated website as soon as practical to improve integration of and access to all information.**

**Recommendation 4.2.2: The new website should include additional self-service functions to reduce the requirement for submission of paper forms and to provide more member information and tools online.**

## **Active members**

**Conclusion 4.3: PEBA communications to active members is cost-effective through extensive use of digital media and appears to be effective; however, some improvements could be considered.**

Communications to active members directly by PEBA spans all the communications vehicles listed in the matrix. For several years, PEBA has been emphasizing email and RSS feeds to improve timeliness and reduce costs as compared to traditional mailings, particularly for newsletters. However, PEBA does not have email addresses for all active members. Insurance brochures are mailed to participants as required. Direct contact with active members is available through training sessions offered at the Visitor Center in Columbia and through education sessions held throughout the state by the Field Services group. Much of the insurance communications to members comes directly from the insurance providers.

According to the most recent CEM study, PEBA member statements do not show members an estimate of future pension entitlements, which is considered a deficiency. Additionally, since the move to email newsletters several years ago, PEBA no longer uses physical newsletters distributed through the U.S. Mail. Lack of both future entitlements estimates on statements and mailed newsletters were considered deficiencies by CEM and resulted in a lower customer service rating compared to peers.

We spoke to five employee groups. Although the employee group Executive Directors indicate that their members are generally very satisfied with the services and communications they receive from PEBA, one group expressed a frustration with “lack of a voice with the PEBA Board,” and “a limited role in nominating the PEBA Board member representatives.”

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**Recommendation 4.3.1:** PEBA should consider mailing newsletters to members with an “opt-out” electronic option for either email delivery or an RSS newsfeed to ensure that all members receive PEBA news on a timely basis.

**Recommendation 4.3.2:** The PEBA Board should play a more active role in reaching out to employee groups on a regular basis to improve communications.

## **Inactive members**

**Conclusion 4.4:** PEBA does not have an active communications approach with inactive members but the PEBA website does provide a tool for inactive members to check their accounts online.

The services available to active and retired members are also available to inactive members, including COBRA benefit recipients, on a self-serve basis via the PEBA website. There is no communications program specifically for inactive employees, which is typical for an agency such as PEBA.

## **Retirees and survivors**

**Conclusion 4.5:** PEBA communications to retirees and survivors is cost-effective through extensive use of digital media and appears to be effective; however, some improvements could be considered.

Communications to retirees and survivors directly by PEBA is extensive for both retirement and insurance and is covered by all the communications vehicles listed in the matrix. PEBA has been emphasizing email and RSS feeds for several years to improve timeliness and reduce costs as compared to traditional mailings. Much of the insurance communications materials are sent directly from the insurance providers.

According to the most recent CEM study, lack of mailed newsletters to annuitants was considered a deficiency by CEM and resulted in a lower customer service rating compared to peers. However, for CEM’s FY 2014 report, this service metric has been changed to “newsletters can be sent through the mail or electronically,” implying that the PEBA score may improve on this metric in the next report.

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We spoke to a retiree group and heard two comments related to communications: 1) there is no public comment period during Board meetings, which makes it very difficult for retirees to be heard; and 2) the Board also does not meet with its constituents on a regular basis.

In the FAS Retirement Administration Agency Peer Benchmarking study we asked peer agencies whether members of the public can make statements at their Board meetings. PEBA's response is reflected by the green shading.

**Table 13 Opportunity for Public Comment**

|                                                                                                                                   | Yes | No |
|-----------------------------------------------------------------------------------------------------------------------------------|-----|----|
| Do your Board meetings typically include a time period on the agenda when members of the public are permitted to make statements? | 2   | 5  |
| Comment: No, but members can if they want.                                                                                        |     |    |

Although it is not a prevailing practice, we believe leading practice is to have a protocol for the Board to accept questions and comments from the public prior to a Board meeting to allow the Board to respond and provide feedback if they choose.

**Recommendation 4.5.1: Consistent with Recommendation 4.3.1, PEBA could consider mailing newsletters to retirees and survivors with an “opt-out” electronic option for either email delivery or an RSS newsfeed to ensure that all retirees receive PEBA news on a timely basis.**

**Recommendation 4.5.2: The PEBA Board should consider developing a process and protocol for receiving and considering public comments before its meetings.**

**Recommendation 4.5.3: Similar to Recommendation 4.3.2, the PEBA Board should play a more active role in reaching out to retiree groups on a regular basis to improve communications.**

### **Personnel and payroll offices**

**Conclusion 4.6: PEBA communications with employer personnel and payroll offices appears to be effective; there are some opportunities for improvement.**

PEBA communications with employer benefit administrators is supported by the Communications Department and the Field Service Unit. Training is available either at PEBA in Columbia or through training and information sessions held throughout the state on a regular basis. Third party insurance providers actively work with PEBA in these sessions. In FY2013, there were 171 retirement events held and 248 for insurance. The digital communications and

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local training sessions seem to be effective; however, it appears to be a challenge for some of the smaller employers to participate and stay up to date.

We interviewed four benefits administrators, two from employers which participate in the retirement plan and two from employers which participate in the insurance program. The administrators report that they are regularly in contact with their counterparts at PEBA, at least monthly, and that the PEBA staff is easy to work with and help to solve any problems which arise.

They reported that their members attend the local education sessions and view them positively. The PEBA Benefits Manual is considered to be very comprehensive and useful. There is an RSS feed for employers which works well and is appreciated by the benefit administrators we interviewed.

The administrators indicated they would like to receive and send less paper and to be able to communicate and submit forms through the PEBA website. Several expressed a desire to be updated about legislative changes on a more timely basis. Another administrator suggested more training on Medicare health options for retiring/terminating employees and more materials on the Medicare choices and the drug plan choice between Catamaran and Medicare Part D plan.

It was also suggested that an employer advisory committee be formed to report problems and health and retirement plans issues, as well as having PEBA attendance at the quarterly School District Benefit Administrator meetings for all school districts in the state.

**Recommendation 4.6.1: PEBA should ensure that its new website has significantly improved functionality for accepting online submission of forms and reports.**

**Recommendation 4.6.2: PEBA communications should review its communications process on legislative changes as they relate to employers and ensure that it results in timely employer updates.**

**Recommendation 4.6.3: PEBA should determine whether having an employer advisory group to provide feedback in a structured manner would be beneficial.**

## **Plan sponsor decision-makers**

**Conclusion 4.7: Opportunities for plan sponsor decision-makers to obtain information regarding PEBA appear to be adequate.**

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Training is available to employer boards either at the PEBA Visitor Center in Columbia or through training and information sessions held throughout the state on a regular basis. Third party insurance providers actively work with PEBA in these sessions. In FY2013, there were 171 retirement events held and 248 for insurance throughout the state.

## **General public**

### **Conclusion 4.8: PEBA's communications to the public meet statutory requirements and the PEBA website makes an extensive range of information available.**

The PEBA Board is considered a "public body" under South Carolina Code § 30-4-20 (state FOIA), which means that board meetings, including subcommittee meetings, must be open meetings, with the exception of executive sessions. The state FOIA code also requires written notice of meetings and publication of minutes. We found PEBA to be in compliance with these requirements.

South Carolina Code § 9-4-50 states "The South Carolina Public Employee Benefit Authority shall maintain a transaction register that includes a complete record of all funds expended, from whatever source for whatever purpose. The register must be prominently posted on the authority's Internet website and made available for public viewing and downloading." We also found PEBA in compliance with this requirement.

The primary communication vehicle from PEBA to the general public is through the website with its general information, annual reports, plan documents, newsletters, board meeting minutes, and videos. The legal disclosure requirements are accomplished through the website. The information available on the website is comprehensive and typical for public retirement agencies. Some of the additional ideas for future development contained in the communications matrix, such as new blog or chat approaches with the Executive Director and/or Board members, could further enhance communications with the general public.

### **Recommendation 4.8: As part of its strategic communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with the general public.**

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## **Advisory groups**

**Conclusion 4.9: The Retirement and Pre-Retirement Advisory Panel previously had an important advisory role to the BCB but appears to now be somewhat redundant with the PEBA Board of Directors.**

Based upon the directive of South Carolina Code § 9-2-10, a Retirement and Pre-Retirement Advisory Panel (the “Panel”) was established before the creation of PEBA to advise the Director of the South Carolina Retirement System on matters relating to retirement and preretirement programs and policies. Although the Panel appears to provide a useful role, it does not advise the PEBA Executive Director or Board regarding programs and policies.

The panel, comprised of eight members appointed by the PEBA Board of Directors (originally by the BCB) and representing various employee and retiree groups, meets several times each year, sometimes with PEBA and RSIC staff and sometime as a Panel meeting. There is not a fixed meeting schedule, but the chair calls meetings as needed. The meetings with PEBA and RSIC have been described by the PEBA Executive Director and the Panel Chair as informational for the Panel members. However, the Panel has not taken positions on issues or provided advice to the PEBA Executive Director or the Board of Directors. In fact, although the Panel is now appointed by the PEBA Board of Directors, during the busy organizational time period since the Board's creation, it has not met with them.

The value which appears to be added by the Panel is two-fold. First, its meetings are open to other employee and retiree groups, and some groups do participate and are informed on topics relevant to their members. Second, although the Panel does not provide advice directly to PEBA on its own, the employee and retiree groups to which its members belong do benefit from the information and provide input to PEBA on behalf of their constituents.

The Panel is legislatively mandated and the PEBA Board is required to appoint its members unless the statute is changed. However, now the PEBA Board also must include representatives of constituent groups, which makes the Panel somewhat redundant. If PEBA improves the effectiveness of its engagement and communications with constituencies as suggested in Recommendations 4.1, 4.3.2, 4.5.2 and 4.5.3, the Panel might no longer be needed. In that event, legislation to repeal the Panel would be required.

Alternatively, the Panel could shift its role to become the PEBA advisory body intended in the statutes. This would require a different approach by Panel leadership and more active engagement with the PEBA Board of Directors and Executive Director. However, this appears that this would duplicate part of the role which the PEBA Board is intended to play as a body that must include constituent representation. It could end up competing with PEBA to engage

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and represent constituency groups, adding another layer of complexity to the overlapping pension and benefits governance structure

**Recommendation 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. See also Recommendation 1.5.**

## **Oversight committees**

**Conclusion 4.10: PEBA's communications to the Budget and Control Board meet statutory requirements.**

According to South Carolina Code § 9-4-45, policy determinations made by the PEBA Board of Directors are subject to approval by the state Budget and Control Board. "Policy determination" has been defined to mean: 1) insurance coverage changes and premium increases; and 2) retirement actuarial assumptions and employer and employee contributions.

On an annual basis, PEBA submits any proposed insurance coverage changes and premium increases, as well as any proposed changes to retirement actuarial assumptions and employer and employee contributions, to the Budget and Control Board for their approval.

All PEBA Board members are appointed by the various members of the Budget and Control Board. Through our interviews with the PEBA Board members, several periodically update their appointing BCB member regarding activities at PEBA but these updates do not seem to be conducted by all PEBA Board members or done on a systematic basis.

We understand that the Budget and Control Board will cease to exist as of July 1, 2015 and its duties will be transitioned to a new State Fiscal Accountability Authority and a new Department of Administration. Although the legislation which makes this change could be clearer, intent of the legislation is that BCB powers to approve PEBA's policy determinations will be transferred to the new State Fiscal Accountability Authority.

**Recommendation 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.**

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## **Legislators**

**Conclusion 4.11: PEBA’s communications to the General Assembly meet statutory requirements; however, there are opportunities to better engage with legislators to advocate for PEBA’s needs.**

South Carolina Code § 9-4-30 (B) states: “The South Carolina Public Employee Benefits Authority shall provide copies of annual actuarial valuations of all retirement systems requiring such annual valuations to the General Assembly by the second Tuesday in January of every year.” These have been provided and presented to the legislature; PEBA staff is typically supported by the PEBA retirement actuary.

During the first two years of PEBA’s operation it appears there was not a systematic approach to engaging legislators aside from the required reporting and budget approval process. This likely contributed to the failure to gain approval for potential legislative changes recommended by PEBA during 2014. The new Executive Director has already been meeting with various legislators regarding future PEBA operating and capital requirements, which should improve PEBA’s engagement with the legislature.

**Recommendation 4.11: As part of its comprehensive communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with key legislators.**

## **5. KEY BENEFITS ADMINISTRATION FUNCTIONS**

### **5.1 Scope of Review**

In assessing PEBA's key benefits administration functions, we evaluated the reasonableness and adequacy of PEBA's key benefits administration process and functionality; due diligence; internal controls; and risk assessment of the Retirement System, Insurance program and other state employee benefits programs administered by PEBA.

The review addressed the following specific topics:

- A. Review of summary plan descriptions
- B. Preparation of benefits statements
- C. Calculation of benefits
- D. Data integrity (age, service, compensation, etc.)
- E. Internal controls designed to identify and mitigate fraud in the benefit section

### **5.2 Standard for Comparison**

We utilized internal interviews with the Executive Director, the Chief Operating Officer, Director of Retirement Systems Finance and staff, Director of Employee Insurance Program Finance and staff, Director of Customer Services and staff.

We reviewed key documents including, Title 9 of the South Carolina Code of Laws, Member Handbooks for the South Carolina Retirement System and the Police Officers Retirement System, information contained on PEBA's website for the Judges and Solicitors Retirement System, the General Assembly Retirement System, the National Guard Retirement System, the Teacher and Employee Retention Incentive Program Overview pamphlet, PEBA's Customer Annuity Claims Procedures, the Service Purchase Policy & Procedures Manual and the Death Claim Procedures agreement with Empower Retirement (formerly Great-West Financial).

We also utilized our review team's public retirement system experience; a new PEBA benchmarking survey specifically for this review; and the FAS public pension governance knowledgebase for a comparison of PEBA practices with peer funds.

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### **5.3 Summary of Key Benefit Administration Function Conclusions**

**Conclusion 5.1: PEBA's key benefit administration functions appear to be reasonable and adequate.**

**Conclusion 5.2: PEBA's member handbooks, guides and summary information are a leading practice in providing plan information to participants and beneficiaries in a format that presents the statutory information in a concise and reader-friendly manner.**

**Conclusion 5.3: PEBA provides Active and Inactive members with an annual statement containing summary benefit information.**

**Conclusion 5.4: PEBA's benefit administration procedures are comprehensive and well-documented.**

**Conclusion 5.5: PEBA's procedures in maintaining data integrity are adequate and reasonable.**

**Conclusion 5.6: PEBA's internal controls are adequate and reasonable insofar as they maintain separation of critical functions and are designed to identify and mitigate fraud.**

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## **5.4 Findings and Recommendations for each Key Benefits Administration Function Conclusion**

### **Background**

PEBA's key benefits administration function is performed by 28 staff members who comprise the Customer Claims Unit. The Customer Claims Unit typically processes approximately 6,500 retirement applications, or annuity claims, annually, but has processed up to 15,000 claims in years when enacted legislation caused a spike in claims.

The Unit is headed by the Director of Customer Services, who reports to the Chief Operating Officer. The Customer Claims Unit consists of three main sub-units, two of which are dedicated to customer claims (i.e., refunds, service and disability retirement applications, death claims, survivor benefits), and one of which is dedicated to service purchases and service audits.

Customer Claims sub-unit A is staffed by 11 employees: a Program Manager, three Benefits Managers and seven Benefits Counselors. Customer Claims sub-unit B is staffed by 10 employees: a Program Manager, five Benefits Managers and four Benefits Counselors. The Service Purchase/Audit Unit is staffed by 7 employees: a Program Manager, a Benefits Manager, three Benefits Counselors and two Program Assistants.

The Customer Claims Unit is fully staffed, however, the current organizational chart indicated six staff members (two from Customer Claims sub-unit A and four from Customer Claims sub-unit B) are Teacher and Employee Retention Incentive (TERI) program participants.<sup>7</sup> The maximum participation period in the TERI program is 60 months and, in any event, the program will be closed effective June 30, 2018.

Therefore, the Customer Claims Unit will lose six of its experienced staff members on or before June 30, 2018.

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<sup>7</sup> The organizational chart PEBA provided to the FAS team is dated September 29, 2014.

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**Conclusion 5.1: PEBA's key benefit administration functions appear to be reasonable and adequate.**

PEBA maintains detailed and comprehensive procedures for each of its key benefits functions. The internal controls that PEBA has integrated into the procedures demonstrate PEBA's recognition of the elements of the process that are vulnerable to error or fraud. Staffing of the units processing benefits transactions is adequate to perform all benefit functions and controls.

Our review found no significant deficiencies or exposures.

**Recommendation 5.1.1: PEBA should continue to maintain internal controls and keep its written policies and procedures current.**

**Recommendation 5.1.2: PEBA should revise its written benefits administration procedures to reflect changes required by the new administration software which will be implemented as part of the new benefits platform.**

## **Review of Summary Plan Descriptions**

**Conclusion 5.2: PEBA's member handbooks, guides and summary information are a leading practice in providing plan information to participants and beneficiaries in a format that presents the statutory information in a concise and reader-friendly manner.**

PEBA's Summary Plan Description (SPD) is set forth in Title 9 of the South Carolina Code of Laws as is typical for a public retirement system. The SPD for most public retirement plans is contained in state law or local ordinance. In addition, PEBA provides summary information in the form of Member Handbooks and information for its retirement benefit programs and insurance plans. There are both full and summary guides regarding PEBA benefit programs and instructions as to how to access the benefits. PEBA also provides versions of these documents on its website.

Title 9 of the South Carolina Code of Laws meets the criteria of a SPD insofar as it adequately communicates plan rights and obligations to participants and beneficiaries. The member handbooks, guides and summary information PEBA exemplifies a best practice in providing plan information to participants and beneficiaries in a format that presents the statutory information in a concise and reader-friendly manner.

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## **Preparation of Benefits Statements**

### **Conclusion 5.3: PEBA provides Active and Inactive members with an annual statement containing summary benefit information.**

PEBA provides Active and Inactive members with an annual benefits statement. The statement provides information such as total contributions and interest, total service credit and current beneficiary information on record. If the member is a participant in the TERI program, the statement provides the member's monthly deferral amount. If the member made an installment service purchase, the statement reflects the member's year-to-date monthly principal and interest payments and principal balance. PEBA also provides members an annual statement summarizing the member's insurance benefits, including types of coverage, premium amounts and dependents of record.

PEBA should consider expanding the scope of information provided on the annual benefits statements to include date of membership and service credit history. This would provide the member an annual opportunity to review his or her service history for accuracy, and to address any discrepancies earlier rather than later. Currently, the member's service record is audited upon the member's retirement. Membership dates and gaps in service history may also prompt the member to purchase unclaimed prior and subsequent service.

Annual statements could also include a projection of death benefits. Members could use this information for estate planning purposes and to inform beneficiaries of benefits that should be claimed from PEBA upon the member's death. Statements could also be designed to reflect certain cautionary or informative indications regarding a member's file, such as "Domestic Relations Order on file" or "no valid beneficiary designation on file." Providing this type of information to members on annual statements will foster more complete documentation in files and clarification of discrepancies in the record sooner rather than later.

Although an annual statement is not printed and mailed to retired members, this information is readily available through Member Access. In an effort to protect confidential and personal information, PEBA has made efforts to eliminate distribution of paper forms to the extent possible.

### **Recommendation 5.3: PEBA should consider expanding the scope of information provided on annual benefit statements.**

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## **Calculation of Benefits**

**Conclusion 5.4: PEBA's benefit administration procedures are comprehensive and well-documented.**

PEBA's benefit administration procedures (i.e., processing of retirement applications, disability applications, death benefit claims, beneficiary designations, refunds and service purchase) are comprehensive and well-documented. PEBA's retirement processing procedures contain multiple layers of data review and verification of data and calculations. Contribution data and information is reconciled quarterly.

## **Data Integrity**

**Conclusion 5.5: PEBA's procedures in maintaining data integrity are adequate and reasonable.**

Data integrity begins with employer data submittals by employers. Employers submit certified data to PEBA directly via electronic forms.

To ensure the integrity of member data, PEBA requires members to submit proof of birth and driver's license with a retirement application. PEBA requires proof of birth for beneficiaries in cases where the member has elected a survivor option and upfront documentation, such as marriage licenses and birth certificates prior to enrollment in insurance benefits.

PEBA procedures with regard to Trusts, Powers of Attorney and Subpoenas are likewise comprehensive and well-documented. With regard to Powers of Attorney (POA), PEBA requires an original or certified copy of the POA before it will honor the request of the designated agent. PEBA procedures also state that it will not honor an agent's selection of a survivor option or designation of a beneficiary without an appropriate court order.

Finally, PEBA reconciles enrollment between insurance files and the Claims Administrators each month (health, dental and vision).

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**Internal Controls Designed to Mitigate Fraud in the Benefit Section**

**Conclusion 5.6: PEBA's internal controls are adequate and reasonable insofar as they maintain separation of critical functions and are designed to identify and mitigate fraud.**

PEBA separates critical functions including separation of benefit calculation and benefit payment processes. PEBA procedures require double approval processes before a payment is approved.

In addition, the Internal Audit function reviews internal control procedures and conducts audits of critical processes. PEBA conducts field audits of employer insurance, but does not audit employer retirement transactions on-site. PEBA has an integrated (insurance and retirement) employer audit function. The audits are performed primarily in-house using retirement, insurance and payroll data to audit enrollment and eligibility of employees, correct insurance premiums, and timely payment of premiums and contributions. This function performs claims audits and other cost containment initiatives, such as the dependent audit and data reconciliations with Medicare.

PEBA's written benefits administration procedures include an administrative review process, which provides time frames for the member to request review and further review.

## **6. ACTUARIAL MATTERS**

### **6.1 Scope of Review**

This review evaluated the reasonableness and adequacy of PEBA's actuarial process, including an analysis of the selection and evaluation process of actuarial services, the scope of work assigned to actuaries and an evaluation of the quality of reports submitted by the actuary.

In addition, the assessment reviewed the process for establishing economic assumptions for the Retirement System and state and local employee insurance benefit programs. The review also assessed the internal controls for validating the data provided to the actuary by PEBA and the external claims data submitted for health and pharmacy utilization.

The assessment of actuarial consulting services and procedures involved interviews with internal and external parties. These included PEBA Board members, PEBA staff, and PEBA's consulting actuary for health insurance and retirement, Gabriel, Roeder, Smith and Company (GRS).

In addition, we reviewed the actuarial reports provided to the PEBA Board and staff, along with a review of the contract for actuarial services between GRS and PEBA. The document reviews included: the number and type of actuarial reports (including the Annual Actuarial Valuation of active and retired lives for the five retirement plans administered by PEBA); the GRS statement for Comprehensive Annual Financial Report (CAFR); the valuation of Other Post-Employment Benefits (OPEB) liabilities resulting from employer financed health and long term disability benefits; and, the 2011 Experience Study.

South Carolina law includes a requirement for conducting an experience study every five years. PEBA's experience study is within normal practice.

PEBA is not required to conduct an actuarial audit. This type of audit is a standard practice among many public retirement systems and is commonly done on a regular schedule. In some systems an actuarial audit is required in state statute. An actuarial audit encompasses more than just recreating contribution rate calculations. It normally includes a review of all actuarial assumptions and a review of all factors used in the development of those assumptions. Actuarial audits can be helpful in providing suggested new approaches to the actuarial processes used in the retirement plan.

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## **6.2 Standard for Comparison**

Our standard for comparison in the benchmarking survey included retirement systems that were structured similarly to PEBA, as well as the experience of the FAS team members in working with similar systems. This assessment utilized internal PEBA staff and Board member interviews, interviews with the external actuaries, review of key documents, FAS team public retirement system experience, a new PEBA benchmarking survey, and the FAS public pension governance database for a comparison of PEBA practices with peer funds. Some of the Systems surveyed did not administer health insurance plans for public employees.

## **6.3 Summary of Actuarial Conclusions**

**Conclusion 6.1:** The overall scope of actuarial services and processes provided to and utilized by PEBA are reasonable and adequate for the retirement, health and disability plans administered by PEBA. The size and experience of the actuarial team used is reasonable and adequate for the required services. There are a few areas where PEBA may be able to take better advantage of the services provided.

**Conclusion 6.2:** The selection process used for actuarial services is reasonable and consistent with prevailing practice for public sector plan administration. The cost is within the lower end of the range for such services. The selection process could be better documented.

**Conclusion 6.3:** The actuarial valuations and experience study are of good quality and consistent with those provided for public pension and health plans generally.

**Conclusion 6.4:** The process for establishing economic and non-economic assumptions is reasonable and consistent with prevailing practice, except with respect to the investment return assumption. The investment return assumption is set by the legislature and there is no required periodic review.

**Conclusion 6.5:** The experience study includes consideration of changes in mortality, but there is no documented process for recommendation of option factor changes.

**Conclusion 6.6:** The PEBA actuary routinely provides projection modeling of the funded status, contribution rate and cash flow requirements over 30-year periods to PEBA staff and the PEBA board. Modeling results are made available to RSIC, however, there is limited interaction between the actuary and RSIC as part of that process. Such interaction could enhance the value of the process.

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**Conclusion 6.7.** PEBA does not routinely conduct actuarial audits as is done in many public retirement systems. Such audits are considered best practice and in some cases are required in state statute. Adopting a policy of regular audits may enhance the oversight process and provide assurances that the actuarial practices being used in development of the annual actuarial valuations and the experience study are within accepted actuarial practices.

**Conclusion 6.8:** PEBA has a well-established and effective process for establishing health premium rates, developed in conjunction with the actuary. Once PEBA finishes computing the premium rates, PEBA might consider having the actuary validate the rates as an additional step in the rate setting process.

**Conclusion 6.9:** PEBA uses the actuary for some counsel on specific plan design and policy related issues, but PEBA could benefit from a coherent forward-looking strategy to address rising health care costs and potentially improve outcomes.

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## **6.4 Findings and Recommendations for Each Actuarial Conclusion**

### **General Actuarial Consulting Services**

#### **Scope of Actuarial Services**

**Conclusion 6.1: The overall scope of actuarial services and processes provided to and utilized by PEBA are reasonable and adequate for the retirement, health and disability plans administered by PEBA. The size and experience of the actuarial team used is reasonable and adequate for the required services. There are a few areas where PEBA may be able to take better advantage of the services provided.**

PEBA has contracted for actuarial services that are appropriate for the benefit plans it administers. The broad scope of the actuarial work covering multiple retirement and health plans requires a large and highly experienced actuarial team of consultants. We found that the size and experience of the GRS consulting team is reasonable and adequate for this engagement. While there is overlap of the actuaries working with the retirement and health care plans, the teams assigned and the lead roles are different for the two areas, thereby providing focus and specialized expertise.

In a few instances, addressed in the recommendations that follow, PEBA should consider whether it can more extensively use the services available under the contract.

**Recommendation 6.1: PEBA should determine whether additional assistance from the actuarial team would be beneficial, as identified under Recommendations 6.6, 6.8 and 6.9 below.**

#### **Procurement**

**Conclusion 6.2: The selection process used for actuarial services is reasonable and consistent with prevailing practice for public sector plan administration. The cost is within the lower end of the range for such services. The selection process could be better documented.**

We note that the actuarial services contract is exempt from the State of South Carolina procurement process. However, the actuarial contract established in 2011 with GRS was the result of a Request for Proposal (RFP) for actuarial services. This is the prevailing practice in public retirement and insurance benefit plan administration in the U.S.

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In our experience, this is the most effective way to obtain actuarial services. PEBA has successfully kept its cost for services in the lower end of the range, without compromising the scope of service. While an RFP process is used, we were unable to identify documentation that PEBA will use that process as a matter of policy.

**Recommendation 6.2: PEBA should develop an internal policy that documents its competitive RFP process in future procurements of actuarial services.**

### **Actuarial Valuations and Experience Study**

**Conclusion 6.3: The actuarial valuations and experience study are of good quality and consistent with those provided for public pension and health plans generally.**

GRS provides both summary findings and detailed analysis in actuarial valuations and presents its findings in person to the PEBA Board and staff several times throughout each year. In addition, the actuaries are available for consultation in person and via telephone during the year to assist PEBA staff and Board members. PEBA does extensive testing of data before submission to the actuary. The actuary does regular testing of data it receives from PEBA and the health plan providers to validate the health and pharmacy claims information it receives.

As a result of GASB 68, PEBA has engaged an external auditor to issue an additional audit opinion on the census data and actuarial schedules that can be relied upon by the auditors of participating employers.

### **Retirement**

#### **Process for Establishing Assumptions**

**Conclusion 6.4: The process for establishing economic and non-economic assumptions is reasonable and consistent with prevailing practice, except with respect to the investment return assumption. The investment return assumption is set by the legislature and there is no required periodic review.**

As part of the experience study conducted every five years, the actuary recommends the economic and noneconomic assumptions used in setting the retirement contribution rates. The recommendations are sent to the PEBA staff and the Board for their consideration. However, the investment return assumption, by law, is set by the General Assembly.

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Legislative control over the investment return assumption is highly unusual and inconsistent with the usual processes adopted in other states with similar systems. It is prevailing practice in public retirement and benefit systems in the U.S. for the actuary to develop and recommend the return assumption to the plan administrator. The benchmarking survey conducted for PEBA showed only one of the peer systems has an assumption set by the legislature. The experience of the FAS team confirms that data. Setting the rate of return comports directly with the fiduciary responsibilities of the PEBA Board and Executive Director.

**Table 14 Authority for Investment Return Assumption**

| Who has final authority for setting the assumed rate of return for system ? | N = 7 |
|-----------------------------------------------------------------------------|-------|
| The legislature                                                             | 2     |
| Retirement system board of trustees                                         | 4     |
| Investment board trustees                                                   | 1     |

This improvement recommendation also was made in the FAS recommendations contained in the Fiduciary Performance Audit of the RSIC released in April, 2014. Legislative action to amend the law would be required to accomplish this change.

As also noted in the April 2014 recommendations contained in the RSIC Fiduciary Performance Audit, there should be a periodic review process. There is no current provision for such a review by the General Assembly.

**Recommendation 6.4: The actuary, in conjunction with the PEBA staff and subject to approval by the Board, should develop and recommend all actuarial assumptions for the pension plan and other benefit plans, including the investment return assumption. If the state law placing responsibility for setting the investment return assumption with the Legislature is not changed, there should be a prescribed periodic review process adopted by the General Assembly.**

## **The Experience Study**

**Conclusion 6.5: The experience study includes consideration of changes in mortality, but there is no documented process for when and how PEBA should adopt option factor changes.**

The experience study examines all economic and non-economic experience for each defined benefit plan administered by PEBA. As part of the study, the actuary determines if mortality rates in the active and retired population have changed to a significant degree from the

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assumed rates. Mortality experience changes potentially affect the actuarial factors used in calculating the Joint and Survivor annuity options that continue benefits to named beneficiaries. In practice, PEBA consults with the actuary concerning whether changes in option factors is indicated, but there is no documented procedure for when and how to adopt option factor changes.

**Recommendation 6.5: PEBA staff should develop procedures, in conjunction with the actuary, to determine when and how to adopt annuity option factor changes.**

### **Projection Modeling Process**

**Conclusion 6.6: The PEBA actuary routinely provides projection modeling of the funded status, contribution rate and cash flow requirements over 30-year periods to PEBA staff and the PEBA board. Modeling results are made available to RSIC. There is, however, limited interaction between the actuary and RSIC as part of that process. Such interaction could enhance the value of the process.**

The projection modeling uses various investment return scenarios to provide a view of the impact of various market conditions on pension plan liabilities. The actuary has provided a software model to the PEBA staff for use in that exercise, and a limited number of PEBA staff are able to use the software. However, RISC does not have access to the software and there is limited interaction involving all three parties (PEBA, RSIC and the actuary) in conjunction with modeling for purposes of assisting RISC understand the long-term impact of investment experience on the funding and cost of the retirement system. Adding such interaction could enhance the value of the exercise.

**Recommendation 6.6: PEBA should consider closer engagement between the PEBA Board, staff, actuary, and the RSIC Board and staff in order to better understand how investment return projections under various asset allocation models may impact plan liabilities and costs.**

### **Actuarial Audits**

**Conclusion 6.7. PEBA does not routinely conduct actuarial audits as is done in many public retirement systems. Such audits are considered best practice and in some cases are required in state statute. Adopting a policy of regular audits may enhance the oversight process and provide assurances that the actuarial practices being used in development of the annual actuarial valuations and the experience study are within accepted actuarial practices.**

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PEBA is not required to conduct an actuarial audit. This type of audit is a standard practice among many public retirement systems and is commonly done on a regular schedule. In some systems an actuarial audit is required in state statute. An actuarial audit encompasses more than just recreating contribution rate calculations. It normally includes a review of all actuarial assumptions and a review of all factors used in the development of those assumptions. Actuarial audits can be helpful in providing suggested new approaches to the actuarial processes used in the retirement plan.

**Recommendation 6.7: PEBA should adopt a policy of conducting regular independent actuarial audits.**

## **Health**

### **Premium Setting**

**Conclusion 6.8: PEBA has a well-established and effective process for establishing health premium rates, developed in conjunction with the actuary. Once PEBA finishes computing the premium rates, PEBA might consider having the actuary validate the rates as an additional step in the rate setting process.**

With the assistance of the actuary PEBA has put in place a system for developing premium rates. The PEBA staff has successfully used this method for developing rates over a period of years. The health plan remains appropriately funded. PEBA works with the actuary to establish the State Health Plan's budgetary/funding requirements by collaborating on enrollment and claims trend as well as plan revenue and expenses. Once budgetary requirements are set, PEBA staff calculates the actual premiums based on those budgetary requirements.

Due to the size of the South Carolina plan, a plan-specific database can be used for this task as well as other plan purposes. In addition, the actuary maintains a national health plan database that can be used for comparison and validation. This information is made available to PEBA.

Having PEBA staff compute premium rates is not unusual among large plans, and PEBA has a history of successfully developing its own premium rates. However, using the actuary for a validation step may strengthen the process.

**Recommendation 6.8: PEBA should consider having the actuary validate the premium rates once PEBA completes the calculation process.**

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## **Plan Design**

**Conclusion 6.9: PEBA uses the actuary for counsel on specific plan design and policy related issues. PEBA could benefit from a coherent forward-looking strategy to address rising health care costs and potentially improve outcomes.**

The actuary provides counsel to the PEBA board and staff on specific plan design and related policy issues. This role is especially pertinent to the health plan, where the legal, economic and technical environments are dynamic.

However, both the PEBA Board and staff expressed the need to establish a more coherent strategy to address rising health care costs and improve health outcomes. Board and staff time and resources could be more efficiently used with a guiding strategy. Given these concerns, consideration should be given to expanding health care consulting arrangements to assist in focusing on developing a coherent strategy. That expansion could include more extensive use of the actuary in this area, or the use of an independent health care consultant.

All of the peers in the benchmarking survey used consulting advice in addressing health plan strategy, design and innovation, whether that advice was from the actuarial firm, a third party consultant, or a third party plan administrator.

**Recommendation 6.9: PEBA should explore additional consulting services for the Health Insurance plans to assist in developing long-term strategies to reduce cost and improve health outcomes.**

## **7. LEGAL COMPLIANCE**

### **7.1 Scope of Review**

The legal compliance assessment evaluated the reasonableness and adequacy of PEBA's legal compliance with existing federal and state laws and statutes governing PEBA. This review is also linked to many of the activities in Category 1: Governance, which covered our review of PEBA's governance practices in the context of applicable laws and regulations. This section addresses the following specific issues:

1. Role of legal counsel in due diligence process
2. Board and staff compliance with plan documents
3. Compliance with "prohibited transactions" requirement
4. Use of internal legal counsel
5. Fiduciary Training

### **7.2 Standard for Comparison**

We created and utilized a checklist of legal requirements on a federal and state level to determine PEBA's compliance. We utilized internal interviews, a review of key documents, our review team experience, a new PEBA benchmarking survey commissioned specifically for this review, and the FAS public pension governance knowledgebase for a comparison of PEBA practices with peer funds.

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### **7.3 Summary of Legal Compliance Conclusions**

**Conclusion 7.1:** PEBA has reasonable processes and review mechanisms in place to determine applicable legal requirements and achieve compliance.

**Conclusion 7.2:** PEBA utilizes qualified internal and external legal counsel to maintain compliance with federal and state requirements. We did not identify any material compliance lapses during the review.

**Conclusion 7.3:** PEBA has implemented tools to monitor and comply with privacy and security requirements.

**Conclusion 7.4:** Legal counsel could improve Trustee and staff training on fiduciary duties through standardized onboarding education, regular updates and use of examples that are targeted to key issues.

**Conclusion 7.5:** Internal legal counsel appears to be appropriately involved in the contracting and due diligence process for PEBA service providers.

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## **7.4 Findings and Recommendations for each Legal Compliance Conclusion**

### **Conclusion 7.1: PEBA has reasonable processes and review mechanisms in place to determine applicable legal requirements and achieve compliance.**

Legal compliance for an organization as complex as PEBA is difficult; multiple layers of federal and state requirements apply to the retirement and insurance programs. Attached as Appendix D is a sample list of the legal compliance requirements applicable to PEBA's plans.

While review of whether PEBA complies with each requirement is beyond the scope of a fiduciary audit, we confirmed that PEBA has the appropriate processes and expertise in place to identify the applicable requirements and ensure compliance. Of note, the General Counsel attends all Board and Committee meetings, advising on issues that arise. He is also involved with senior staff in responding to questions and advising on the permissibility of actions.

The internal legal staff is also involved in reviewing a variety of PEBA-related documents, including contracts and requests for proposals, forms, policies and legislation. PEBA also appears to accurately apply plan provisions in benefit determinations. Participants whose benefit appeals have been denied may appeal to the Administrative Law Court for review.

Of the 15 Administrative Law Court decisions that we reviewed, all that reached a final decision upheld PEBA's benefit denial.

### **Conclusion 7.2: PEBA utilizes qualified internal and external legal counsel to maintain compliance with federal and state requirements. We did not identify any material compliance lapses during the review.**

PEBA has a general counsel and two additional internal attorneys. An open fourth position is in the process of being filled. It works with outside legal counsel when appropriate and necessary. Legal staffing levels and use of outside counsel at PEBA are consistent with its peers. All of the internal counsel attorneys have multiple years of experience in the benefits area. They are members of a number of national trade organizations in the retirement and insurance areas, attending conferences sponsored by those organizations, as well as partaking in other educational opportunities as appropriate.

PEBA utilizes Ice Miller for consultation on compliance issues for the retirement and insurance plans. This includes filing for an Internal Revenue Service ("IRS") determination letter for each retirement plan during the Pension Protection Act ("PPA") Cycle C remedial amendment cycle. It is important for PEBA internal legal staff to have access to outside counsel with expertise in the benefits area, especially for public plans, due to the complexity of the requirements.

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PEBA has also utilized other outside counsel for procurement and litigation purposes. In order to secure the expertise necessary for public plan work, the Attorney General may need to provide flexibility in approving outside counsel with a national practice, and corresponding out-of-state fees. PEBA also utilizes its consultants in providing advice and review of plan benefits and requirements.

All of PEBA's plans received favorable determination letters based on the most recent filings. The determination letters were issued on each retirement plan between March and June 2014, and expire January 31, 2019 at the end of the next remedial amendment cycle. A favorable determination letter from the IRS means that the IRS has approved the plan document from a tax qualification standpoint. It is best practice to obtain them. Ice Miller also provides an annual review of the retirement plans to determine federal compliance. It works with internal counsel to draft any necessary amendments.

With regard to the insurance plans, PEBA's internal counsel utilizes outside legal counsel and consultants to monitor changes in legal requirements. Continued review of changing regulatory requirements is especially important with health plans as additional guidance and requirements are introduced under the Affordable Care Act. No similar qualification process exists for health plans as exists for qualified retirement plans.

However, PEBA's general counsel consults with outside counsel and PEBA's other consultants with regard to changing regulatory requirements and compliance. In addition, Ice Miller provides an annual review of the health and cafeteria plans for federal compliance purposes and works with internal counsel to modify the plans as necessary. However, PEBA could also use additional resources, such as DOL checklists and self-compliance tools, as guides for its review.

In addition to federal requirements, state statutory requirements apply to the retirement and insured plans. The statutes provide more specific requirements for the retirement plans, while providing more generally that health insurance shall be offered. With regard to state law, PEBA's internal legal counsel drafts and reviews legislation relating to PEBA.

**Recommendation 7.2: In conjunction with outside legal counsel, PEBA legal staff should continue to perform periodic reviews of changes in the law and the plans' compliance with federal and state law requirements.**

**Conclusion 7.3: PEBA has implemented tools to monitor and comply with privacy and security requirements.**

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The Health Insurance Portability and Accountability Act ("HIPAA") requires group health plans to comply with its privacy and security requirements in an effort to maintain confidentiality of participants' protected health information ("PHI"). PEBA has implemented appropriate procedures for HIPAA compliance. PEBA maintains detailed policies for compliance, discussed in section 2 above, and maintains business associate agreements when appropriate and required.

We also were able to evaluate PEBA's compliance with the HIPAA requirements in handling an inadvertent PHI breach by a subcontractor. Loss of control over its members' PHI occurred when a password-protected laptop was stolen from a subcontractor. The HIPAA privacy rule contemplates that incidents like this will happen and, accordingly, outlines a process for addressing them. PEBA implemented the legally required steps to investigate the incident and notify affected members, advising them of steps to take in protecting against potential identity theft and credit monitoring, demonstrating a strong process. It also terminated the subcontractor that caused the breach.

HIPAA recognizes that group health plans need to disclose PHI to perform necessary functions. However, HIPAA requires that plans only disclose the minimum amount of PHI necessary for the intended purpose. During the review, we became aware that some internal PEBA training documents unnecessarily include PHI. PEBA has addressed the situation, and we did not identify any other breaches during the review.

However, special attention should be paid to control of hard copy documents with PHI because it is easier to lose control over paper copies. Consideration should be given to avoiding the generation of PHI hard copies when paper copies are not required, to automatic shredding of unneeded hard copies and to limiting the print function for electronic documents that contain PHI when hard copies are not required.

**Recommendation 7.3: PEBA should review its printed training materials, reports and use of protected health information to make sure its minimum necessary standards are being consistently applied.**

**Conclusion 7.4: Legal counsel could improve Trustee and staff training on fiduciary duties through standardized onboarding education, regular updates and use of examples that are targeted to key issues.**

As outlined in Section 1 regarding governance, PEBA Board members are fiduciaries and, as such, are subject to certain fiduciary standards. Primary fiduciary duties include the duty of

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loyalty, duty of care, and duty of impartiality. A comprehensive description of these standards is included in section 1.4 Background earlier in this report.

In addition to fiduciary duties, PEBA is subject to federal and state prohibited transaction standards. While qualified government retirement plans are not subject to the ERISA prohibited transaction requirements which cover private pension plans, they are subject to the prohibited transaction rules of the Internal Revenue Code ("Code") contained in IRC section 503.

Under Code section 503(a), a qualified plan could lose its tax exempt status if it engages in a prohibited transaction. The Code section 503 standards generally prohibit diversion of trust assets for non-plan purposes or for less than adequate compensation. Board members and staff are also subject to the State Ethics Act, and Board members also must comply with the supplemental conflict of interest policy the Board adopted, as discussed in section 2 above. We did not identify any apparent fiduciary duty or prohibited transaction violations during our review.

However, we learned during interviews that some Board members have not yet received full training on their fiduciary obligations or on prohibited transactions. In addition, the Board would benefit from greater clarity on application of the fiduciary duty of loyalty, which runs solely to beneficiaries, as well as on the different roles of Trustees and the plan sponsor. Fiduciary training is an integral component of ensuring that Board members comply with their fiduciary obligations.

We recommend that Board members receive comprehensive on-boarding fiduciary training, with refreshers at least annually. Training can take on a variety of formats, but we have found that comprehensive educational presentations on fiduciary duty are more effective when supplemented with other learning opportunities. Repetition over time and presentation of concepts in both visual and verbal media, combined with use of relevant discussion examples, tends to be more effective for training purposes than a single education session. Also, staff should receive training on their ethical obligations, which should be formalized in a training schedule to ensure training is conducted.

**Recommendation 7.4.1: PEBA should provide periodic fiduciary training to staff and Board members through standardized onboarding education, regular updates and use of examples that are targeted to key issues.**

**Recommendation 7.4.2: PEBA should formalize a staff training schedule to ensure that consistent ethics and compliance training is conducted.**

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**Conclusion 7.5: Internal legal counsel appears to be appropriately involved in the contracting and due diligence process for PEBA service providers.**

PEBA's internal legal staff appears to be appropriately involved in the procurement and due diligence process for PEBA's service providers as necessary. One of the internal attorneys is tasked with handling procurement issues in coordination with the procurement officer. We reviewed a sample of PEBA's requests for proposals (RFPs) and contracts with service providers.

The RFPs are extensive and contain standard questions and provisions, including whether the service provider will assume fiduciary status, when appropriate, and indemnify the state for the service provider's errors. Review of a sample of service provider contracts also indicated that standard terms were included in the contracts, including indemnification, reasonable termination provisions, and a comprehensive description of the services to be provided.

PEBA's investment advisors for the ORP and Deferred Compensation Program are subject to both federal and state pay-to-play requirements. The Securities and Exchange Commission Rule 206(4)-5 contains a two-year prohibition on an adviser's providing compensated services to a government entity following a political contribution to certain officials of that entity; a prohibition on the use of third-party solicitors who are not themselves subject to pay-to-play restrictions on political contributions; and a prohibition on efforts by advisers to solicit political contributions to certain officials of a government entity to which the adviser is seeking to provide services.

**Recommendation 7.5: PEBA should confirm that ORP and Deferred Compensation investment advisors acknowledge their compliance with the SEC 'pay to play' regulations and state requirements.**

## **8. TYPES AND LEVELS OF CUSTOMER SERVICE**

### **8.1 Scope of Review**

Our review evaluated the reasonableness and adequacy of PEBA's types and levels of customer service. We also evaluated the effectiveness of PEBA's customer service and communications with its stakeholders, beneficiaries and participants. The review addressed the following specific topics:

1. Quality of customer service
2. Satisfaction surveys and follow-up
3. Communication channels, content, and form
4. Response turnaround time

### **8.2 Standard for Comparison**

We utilized internal interviews, a review of key documents and PEBA customer service surveys, a new PEBA benchmarking survey designed and conducted specifically for this review, and our review team's experience in public retirement systems and other relevant organizations.

In addition, we utilized the 2013 CEM Pension Administration Benchmarking report (the most recent) and its findings as a key data source for pension administration operations. FAS contracted with CEM to provide FAS with additional input and analysis on their report.

We also collected and analyzed all the key internal performance standards that PEBA has established, particularly for health insurance, disability and life insurance, as these were not included in the CEM benchmarking.

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### **8.3 Summary of Customer Service Conclusions**

**Conclusion 8.1:** Based upon our interviews and review of customer service metrics, it appears that PEBA's core value of providing "outstanding products, excellent customer service and continuous improvement" is being fulfilled by the PEBA staff.

**Conclusion 8.2:** PEBA Call Center surveys regarding service timeliness, courtesy, and effectiveness, indicate a very high level of overall satisfaction.

**Conclusion 8.3:** Despite an increase in FY12 and FY13 due to retirement legislation, visitor center wait times for retirement and insurance have been reduced to historical lows in FY14. Visitor Center customer satisfaction has remained over 99% for each of the past ten years and was at 99.58% in FY14.

**Conclusion 8.4:** The customer surveys, as well as the internal metrics, administered within the groups with a customer interface appear to be effective and are used by the management team to continuously improve operations and responsiveness.

**Conclusion 8.5:** The 2013 PEBA customer satisfaction survey asked numerous questions and was structured around seven different constituent groups, but it did not seem to be effective and was not linked to any actionable operating metrics.

**Conclusion 8.6:** Based upon the 2013 CEM benchmarking study, PEBA's retirement customer satisfaction surveying process rated higher than the peer median but could still be improved.

**Conclusion 8.7:** PEBA relies heavily upon its website and electronic media as its first line of customer service; while this is appropriate and effective, many members and, especially, retirees, are not reached through electronic channels.

**Conclusion 8.8:** Although many retirement and insurance forms are available to members online through the PEBA website, there are limited opportunities for members to submit or update retirement information electronically through the website.

**Conclusion 8.9:** Based upon the 2013 CEM benchmarking study, PEBA's retirement payment and pension inception processing also compared favorably to peers. In 2013, PEBA's rate of achieving the initial payment for new retirees within the first month of retirement was 99.3% compared to 89.2% for the peer group.

**Conclusion 8.10:** PEBA's activity service score for withdrawals and transfers-out was above the peer median score in CEM's 2013 study.

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**Conclusion 8.11:** PEBA's service credit purchase processing cycle time was slightly better than the peer average in CEM's 2013 study.

**Conclusion 8.12:** PEBA's activity service score for Disability was better than the peer median in CEM's 2013 study.

**Conclusion 8.13:** Although PEBA's activity score for the Call Center, specifically, call wait time and good call outcomes was close to the peer average, there is room for improvement.

**Conclusion 8.14:** PEBA counsels a higher percentage of members on a one-on-one than their peers. There is also minimal wait time for a counseling session at PEBA. However, there is one area in this activity to consider for potential improvement.

**Conclusion 8.15:** A material number of PEBA members attended field presentations and group counseling sessions although the percentage of 2.4% of active members was lower than the peer average of 5.5%. Also, the average number of attendees per presentation was larger than the peer average. Smaller groups are generally preferred as there is more opportunity for individual attention.

**Conclusion 8.16:** PEBA has same-day turnaround on written pension estimates compared to an average of nine business days among peers.

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## **8.4 Findings and Recommendations for each Customer Service Conclusion**

### **Background**

The Customer Services Division of PEBA reports to the Chief Operating Officer and includes approximately 90 staff organized into four main groups:

- The Call Center, with a staff of 40 directed by three supervisors and responsible for Retirement, Insurance, and Benefit Administrators (BA) call lines;
- Customer Intake (Insurance Counselors and Retirement Counselors) and a Field Education staff totaling 20 employees;
- Customer Claims which includes Claims Processing (Annuity, Refund and Death Claims) and Service (Service Purchase and Service Audit) with a staff of 28; and,

The Communication Department, with a staff of 7, is responsible for the PEBA website and other supporting customer service activities. It was recently transferred to report to the COO and is no longer part of the Customer Service Division.

The Customer Intake group provides one-on-one counseling for members and subscribers. The Field Education group works with employers and employer boards to enroll new groups into PEBA's plans. For insurance plans, the third party providers work with Field Education to support the employers and employees. Over the past year 171 retirement education events were held around the state and 248 were held for insurance. The peak period for enrollment is in the spring.

The Claims Processing unit of Customer Claims is responsible for processing refund, death, and annuity claims. The Service Purchase unit of Customer Claims is responsible for providing service purchase invoices. The Claims processing unit typically processes about 6,500 annuity claims annually, but in years of significant legislative changes this has spiked to 12,000-15,000. The retirement claims process is tightly linked with payroll processes. All transactions go through a quality assurance process.

The disability appeals process is handled by an administrative law judge. If a member files an appeal, the PEBA legal staff handles it, often with the assistance of a consultant. If a settlement is not reached the appeal will again go to a judge for resolution. Each insurance product has its own appeals process.

For death claims, PEBA has an objective of sending out a letter to the survivors within 2-3 days with instructions on how to file a death claim. The objective is to send out the first death benefit payment within 30 days to ensure continuity of income for the family. The cycle time and error rates are monitored.

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Since the formation of PEBA in 2012 there has been an ongoing effort to achieve efficiencies through consolidation and standardization of processes between retirement and insurance operations wherever it was practical. The call centers are the most advanced in achieving integration. Most staff have received cross training to be able to handle either retirement or insurance calls, as necessary. Further standardization is still in process and planned for the future.

### **Overall Quality of Customer Service**

**Conclusion 8.1: Based upon our interviews and review of customer service metrics, it appears that PEBA's core value of providing "outstanding products, excellent customer service and continuous improvement" is being fulfilled by the PEBA staff.**

The PEBA 2013-14 Strategic Plan describes a Core Value of **"Quality Customer Services and Products** – We consistently provide outstanding products and excellent customer services, as defined by our customers, and we strive for continuous improvement. Our interaction with customers is fair, fast, simple and comprehensive."

In the retirement area, Customer Claims measures key internal performance metrics and also has accountability standards for several key retirement areas, such as:

- *Refunds*: Release payments so that refunds can be paid within 30 days of receipts of the refund application or 90 days after the member's termination of covered employment, whichever is later;
- *Deaths* : Accurately update records as additional information is received and release payments for workable claims within 30 days after notification of death;
- *Disability retirement claims annuities*: Worker disability claims are processed and released for initial payment within 30 days of approval and finalized benefits are released for payment within 30 days of members receiving their first benefit check, once files become workable; and,
- *Service retirement claims annuities*: Workable service annuity claims are processed and released for initial payment within 30 days of member's date of retirement (or date application received if filing retro-actively) and finalized benefits are released for payment within 30 days of member's receiving their first benefit check, once files become workable.

In Customer Claims, cycle times are measured and error rates are monitored on a regular basis and reports are prepared monthly.

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A number of different customer satisfaction surveys are conducted by PEBA, some periodically and others on an ongoing basis. They have been administered by four different units within Customer Service: Call Center; Visitor Center; Field Services; and Communication. After the current reorganization is complete, Field Services will report to the new Employer Services Department under the COO, and Communications will report directly to the COO.

Customer satisfaction reporting to the PEBA Board of Directors has typically been accomplished through the annual Accountability Report which is prepared by the Communication Department. Questions about the utility of the annual Accountability Report were raised in a number of interviews. However, it is our understanding that the Accountability Report content and format is required by the General Assembly and PEBA does not have discretion to change or eliminate the report.

### **Call Center**

**Conclusion 8.2: PEBA Call Center surveys regarding service timeliness, courtesy, effectiveness, indicate a very high level of overall satisfaction.**

For FY13 and FY14, Call Center survey results were:

- Timeliness was 98+%
- Courtesy and respect was 99+%
- Effectiveness was 97+%
- Overall satisfaction was 97+%

The call centers are the primary customer service resource for retirement members, retirees and employers if the PEBA website is insufficient to accommodate their needs. A percentage of calls with basic questions can be handled with automated responses without the assistance of a call center representative.

Typical call center support includes retirement counseling and assistance in making calculations. The busiest period for retirements is during July.

For insurance, aside from member eligibility or plan changes, in most cases the primary call center support is provided by the insurance vendors and the PEBA call center performs a tertiary role. There are three employees of the Pharmacy Benefit Manager who work on-site at PEBA. The peak period of activity is during open enrollment in October.

Call center counselors have access to a variety of information systems including imaging, the automated retirement system, and the pharmacy benefit manager system. Accessing

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retirement and insurance accounts of a member still requires utilizing at least two separate systems and often as many as seven or eight applications simultaneously. Counselors utilize two or three screens to be able to view multiple systems.

Metrics which are tracked and monitored are typical for a call center and include: wait times; call length; abandoned calls; hold time; availability; and calls per representative.

Cross-training of call center counselors was a major initiative after the creation of PEBA. There had been a significant amount of turnover in the insurance call center, and many of the retirement agents volunteered for the five to six months of insurance training.

The call management system appears to have functionality limitations which impact productivity. The call center has requested a new system with additional capabilities and features. They would also like to have the capability of recording all calls rather than the sampling which is recorded today.

Counselors also handle member correspondence. The technology supporting member correspondence is not up to date and counselors must use manual templates to respond to inquiries.

**Conclusion 8.3: Despite an increase in FY12 and FY13 due to retirement legislation, visitor center wait times for retirement and insurance have been reduced to historical lows in FY14. Visitor Center customer satisfaction has remained over 99% for each of the past ten years and was at 99.58% in FY14.**

Survey results show that there were retirement wait time increases in FY12 and FY13 which peaked at 12 minutes but have been reversed in FY14 and are now at 6 minutes, near the historical lows. Insurance intake wait times have steadily declined since FY12 and were at 5 minutes in FY14.

### **Satisfaction surveys and follow-up**

**Conclusion 8.4: The customer surveys, as well as the internal metrics, administered within the groups with a customer interface appear to be effective and are used by the management team to continuously improve operations and responsiveness.**

The various customer satisfaction surveys conducted by the Call Center, Visitor Center, Field Service, as well as the operating metrics monitored within Customer Claims, appear to be used

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effectively as a tool by management to quickly identify potential issues. In the call centers, they are used to identify coaching opportunities and monitor overall performance. In the Visitor Center, the surveys provide feedback to address potential instructor deficiencies or improvement opportunities in training classes. Field Services customer surveys appear to be most helpful for identifying emerging issues which need to be addressed.

At the end of each call, the caller is directed to a customer satisfaction survey. Call center representatives encourage callers to participate in the survey; it is estimated that 20-25% of callers do choose to participate. The results of these surveys are used by Customer Service supervisors and management for performance monitoring. Potential problems are identified and addressed and exceptional results are also identified. If a representative appears to need coaching their calls will be monitored and improvement opportunities identified.

Prior to November 2013, PEBA Customer Intake called a random sample of visitors to the Visitor Center (intake visitor) and asked three qualitative survey questions and one open-ended question. Since November 2013, each visitor supplies their email address and receives an email survey asking the same questions. In addition, wait time is monitored for both retirement intake and insurance intake and the number of emails received is tracked for retirement and insurance.

Field Services administers two surveys, one for employer benefit administrators who receive training and another for members who attend insurance training sessions. The employer questionnaire for insurance training contains five multiple choice questions plus an open-ended question. The employer questionnaire for retirement training asks for three sets of ratings on each of seven topical training areas.

**Recommendation 8.4: PEBA should develop a more standardized approach for performance monitoring and customer satisfaction surveys with common tools, data and reporting.**

**Conclusion 8.5: The 2013 PEBA customer satisfaction survey asked numerous questions and was structured around seven different constituent groups, but it did not seem to be effective and was not linked to any actionable operating metrics.**

PEBA's Communications Department previously conducted an annual customer satisfaction survey with a sample of retirees from the prior twelve months using a short paper customer satisfaction survey. The Communications Department, working under the direction of a Board member, developed a significantly expanded survey in 2013. The new survey was administered online with Zipsurvey, although it was also mailed to members 60 years of age and older. The paper copies were keyed into Zipsurvey manually by PEBA staff.

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The 2013 survey used different questions targeted for nine different groups:

- Five retirement system groups: Active and retired members from SCRS and PORS and employers
- Four insurance groups: Active and retired employees, inactive COBRA employees, and employers

For several groups there were as many as 26 questions.

The results of this survey have been prepared in nine different reports and distributed to appropriate PEBA staff. However, there was not a plan for following up and it is not clear that the results are being used. We were told that a draft report is being prepared for the Board.

Although the 2013 customer service survey asked a large number of questions, they were not designed to develop any diagnostic information which could assist in identifying and prioritizing operational improvement opportunities. In addition, the survey was not developed as part of a broader customer service monitoring and improvement initiative and consequently suffers from a lack of follow up and efficacy.

Due to the extensive nature of this report, as well as the lack of follow up to date, the survey has not been administered again in 2014 and future plans appear uncertain.

**Recommendation 8.5.1: PEBA should identify the key areas and metrics for customer service monitoring and develop a comprehensive, integrated customer service monitoring framework which is used to drive its customer surveys and follow-up improvement programs.**

**Recommendation 8.5.2: The PEBA Customer Service Department should establish a small group with expertise in customer service metrics and monitoring, or conversely, utilize an outside specialist firm to assist in developing its customer service monitoring approach and tools.**

### **Retirement Customer Satisfaction**

**Conclusion 8.6: Based upon the 2013 CEM benchmarking study, PEBA's retirement customer satisfaction surveying process rated higher than the peer median but could still be improved.**

CEM evaluated nine member transactions for surveying service satisfaction. PEBA collects service satisfaction responses in six of the nine activities evaluated. The CEM scores for PEBA's customer satisfaction surveying were:

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- One-on-one counseling – 100 out of 100
- Member presentations – 100 out of 100
- Member telephone calls – 100 out of 100
- Pension inception – 5 out of 100 because the survey is not single activity focused but part of a general annual survey
- Written pension estimates – 60 out of 100 because the survey is not single activity focused but part of a general annual survey
- Disability – 5 out of 100 because the survey is not single activity focused but part of a general annual survey

The three areas which CEM evaluates where PEBA does not obtain customer service feedback include:

- Secure member area of the website – PEBA does not have a secure area on its website
- Withdrawals and transfers-out
- Purchases and transfers-in

**Recommendation 8.6: PEBA should re-evaluate its satisfaction surveying process to include single activity surveys for disability, pension inceptions, withdrawals and transfers-out and service credit purchases.**

## **Communication channels, content and form**

### **Background**

The Communication Department is responsible for managing the PEBA website, producing and distributing all PEBA publications, and maintaining social media such as Facebook, Twitter and LinkedIn as well as providing the RSS feed for members and employers. Email is the preferred communication channel for retirement due to its low cost and timeliness; however, PEBA only has about 150,000 email addresses. With over 400,000 active and retired members, this implies that PEBA can reach fewer than half its members via email.

Communication also monitors external and internal events to anticipate any situations which could cause an increase in customer service requests and notifies the Call Center and Intake Departments.

The PEBA websites are described in further detail in *Section 4. Content and Form of Communication with Members*. Although the website is a key communication tool, it also serves as a first line of customer service, with plan and coverage information, member

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statements and account information, forms, reports, newsletters and other information for members.

The PEBA website, in addition to providing information, also provides customer self-service for certain functions.

For retirement services, active members can view and update their personal information online and submit applications online up to six months in advance of retirement. Member statements are available online, with emails and newsfeeds alerting members to their availability. A member can call to request a hard copy. All forms are available online but must be printed and physically submitted; online form submission is not available.

A video library available on demand provides plan overviews as well as assistance in selecting a retirement plan and explaining average final compensation. Members also have access to pre-retirement planning materials and benefits calculators, although active members cannot download their data into the benefit calculator to get an accurate estimate without transferring data to paper and then reentering the data into the calculator. There is also a New Employee Resource Center to assist new employees in understanding their retirement benefits and making retirement plan selections.

Inactive members can look up their account in each defined benefit plan through either their social security number or name and date of birth.

The Retiree Resource Center provides information, forms, and publication for retirees. It includes information on payment dates, adjustments, death benefits, beneficiary changes and taxes. Changes of address can be updated online through the retiree account.

The PEBA Employer Resource Center makes available the information, forms, and employer training necessary for employers to provide the administration of retirement benefits, including a detailed employer manual, contribution rates and guidance on complying with GASB reporting requirements, and how to obtain assistance. Employer accounts are set up on the EES website. An employer newsfeed is available as a syndicated RSS subscription. Planned employer training dates around the state are available and employers can download and print all training materials.

For insurance services, the website offers forms for insurance elections, HIPPA, COBRA coverages, and a variety of other situations. Coverage and eligibility information for Active Employees, COBRA Subscribers, Retirees, Survivors, Spouses and Children, and Local Subdivisions is available. Plan descriptions, premium information, and related brochures are available for all programs offered by PEBA. Open enrollment and other training and education

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presentations are available for downloading. The website explains the Tobacco Program and provides related forms and information.

The Prevention Partners portion of the Insurance website includes an overview of the program and numerous pages of detail, including a description of wellness and prevention benefits, workplace screenings information, a training calendar, and newsletters. There is also a section for employer benefits administrators to obtain information and log in.

MyBenefits allows subscribers to change their contact information, beneficiaries, review benefits and print a benefit statement, as well as obtain their Benefits Identification Number (BIN). During the annual enrollment period subscribers can make their own changes using MyBenefits and throughout the year Benefits Administrators can process special eligibility changes or new hires using Employee Benefits Services (the employer's on-line website). For claims information the website contains links to each of the insurance programs through the carrier websites.

**Conclusion 8.7: PEBA relies heavily upon its website and electronic media as its first line of customer service; while this is appropriate and effective, many members and, especially, retirees, are not reached through electronic channels.**

PEBA only has about 150,000 email addresses but over 400,000 active and retired members. It appears that fewer than half of all PEBA active and retired members regularly receive electronic communications, with this likely skewed heavily to retired members. It is not clear how many members do not have regular internet access to the PEBA website. Considering the large proportion of members for whom PEBA does not have an email address, PEBA should consider alternatives for more effectively reaching this portion of its population.

**Recommendation 8.7.1: PEBA should obtain the email addresses of a much higher proportion of its members, particularly retirees, to ensure they receive news electronically.**

**Recommendation 8.7.2: PEBA should consider alternative means of reaching members if they do not use email or the internet.**

**Conclusion 8.8: Although many retirement and insurance forms are available to members online through the PEBA website, there could be more opportunities for members to submit or update retirement information electronically through the website.**

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Active retirement members can view and update their personal information online and all forms are available online; however, the forms must be printed and physically submitted. Similarly, although members have access to pre-retirement planning materials and benefits calculators, they cannot download their data into the benefit calculator to get an accurate estimate without transferring data to paper and then reentering the data into the calculator.

Among employers and their benefits managers, there is a desire to receive and send less paper and to be able to communicate and submit forms through the PEBA website.

**Recommendation 8.8: As PEBA develops its new website, it should place a high emphasis on maximizing self-service capabilities for both members and employers.**

### **Response turnaround times**

#### **Overall**

**Conclusion 8.9: Based upon the 2013 CEM benchmarking study, PEBA's pension retirement and inception processing compared favorably to peers. In 2013, PEBA's rate of achieving the initial payment for new retirees within the first month of retirement was 99.3% compared to 89.2% for the peer group. For survivor pensions, PEBA similarly achieved a 99% initial payment rate within one month, compared with an average rate of 74% in the peer group.**

PEBA reported having no late payments while on average peers reported one delayed payment cycle. In addition, PEBA's advices are available online and can include messages. PEBA eliminated printing and distribution of bi-annual payment advices over a year ago in October 2013. Annuitants cannot choose whether or not to receive a payment advice. PEBA will deduct amounts from the annuity payment for insurance services offered by PEBA.

Most (96%) of PEBA's initial payments were based upon estimates, which is typical. PEBA was able to finalize the payment calculations on average within 2.3 months, compared to 3.6 months for the peer group.

For survivor pensions, PEBA similarly achieved a 99% initial payment rate within one month, compared with an average rate of 74% in the peer group.

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## **Refunds, Withdrawals and Transfers-out Processing**

**Conclusion 8.10: PEBA's activity service score for withdrawals and transfers-out was above the peer median score in CEM's 2013 study.**

Withdrawals were completed on average within 40 days compared to a peer average of 40 days, and transfers-out in 22 days compared to an average of 36 days. Statute requires PEBA to require notarization of transfer-out applications which CEM considers unnecessary red tape. PEBA does not believe notarization is a necessary control.

**Recommendation 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.**

## **Service Credit Purchase Processing**

**Conclusion 8.11: PEBA's service credit purchase processing cycle time was slightly better than the peer average in CEM's 2013 study.**

PEBA reported that purchase of service credits required 15 days from request to a written cost to be provided. This compared to a peer group average of 16 days. The benchmark for providing a written cost for a service credit purchase is 1 day.

## **Disability Claims Processing**

**Conclusion 8.12: PEBA's activity service score for Disability was better than the peer median in CEM's 2013 study.**

PEBA's processing cycle time for disability applications was at the peer average of two months but because PEBA does not require the applications to be notarized it is considered a better process.

## **Service Score**

**Although PEBA's activity score for the Call Center, specifically, call wait time and good call outcomes was close to the peer average, there is room for improvement.**

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The 2013 CEM calculated overall service score for the PEBA call center was 49 out of 100 compared to a peer median of 53. The primary differences which caused PEBA to be below the median were:

- More limited hours of operation (42.5 compared to CEM's standard of 50)
- Slower email response time (1 day compared to a 4 hour standard)
- Average number of menu layers a caller must negotiate (2 layers versus a standard of 1)
- More limited real-time information available for representatives to reference
- No tools to project call volumes
- More limited review of member calls for staff coaching (2 versus a standard of 4 per month)

**Recommendation 8.13.1: PEBA should consider if expanded hours for its call center would result in improved customer service.**

**Recommendation 8.13.2: PEBA should evaluate new phone and email management systems and consider acquiring newer technologies if they could improve service levels and/or staff productivity levels.**

### **One-on-One Counselling**

**Conclusion 8.14: PEBA counsels a higher percentage of members on a one-on-one than their peers. There is also minimal wait time for a counseling session at PEBA. However, there is one area in this activity to consider for potential improvement.**

The CEM study reported that PEBA provided one-on-one counseling to 6.6% of its members in 2013, significantly more than the peer average of 3.9%. The service was also freely available to all members, including both scheduled sessions and walk-ins. However, PEBA only offers one-on-one counseling at its Visitor Center in Columbia while many peer agencies offer sessions in field locations, particularly at employer locations, where over 28% of sessions were held among the peer agencies.

PEBA's activity score for one-on-one counseling was slightly below the peer median score. PEBA did score higher for their counseling service capability because counselors are able to provide real-time member information for scheduled sessions and walk-ins.

We were informed that the counselors for the Visitor Center are comprised of seasoned representatives who have transferred from the Call Center. All of these representatives have had previous rotations in the Visitor Center so the experience of seeing visitors is not new.

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New counselors are shadowed by a manager for a short period of time. If any issue concerning a counselor is brought to management's attention, a coaching session is held with the counselor. Counselors receive training on new legislation, procedures, and guidelines impacting insurance and retirement.

**Recommendation 8.14: PEBA should consider if offering one-on-one counseling sessions at employer sites would result in improved customer service and participation levels.**

## **Retirement Presentations**

**Conclusion 8.15: A material number of PEBA members attended field presentations and group counseling sessions although the percentage of 2.4% of active members was lower than the peer average of 5.5%. Also, the average number of attendees per presentation was larger than the peer average. Smaller groups are generally preferred as there is more opportunity for individual attention.**

Although the 3.4% of members who attended PEBA retirement field presentation and group counseling sessions was less than the peer group average of 5.5%, in consideration of the high participation in one-on-one counseling, 10.0% of PEBA members received retirement education in 2013 compared to 9.4% for the peer group. However, the average group size of 55 members was higher than the peer group average of 37. This may be because PEBA offered less than one-third the number of sessions as compared to the peer average. Four out of five peers also offer webcasts of presentations, while PEBA does not.

**Recommendation 8.15: PEBA should consider increasing the number of retirement presentations it offers in the field to reduce the size of the groups and allow more individual attention.**

## **Written Pension Estimates**

**PEBA has same-day turnaround on written pension estimates compared to an average of nine business days among peers.**

PEBA's same-day pension estimate turnaround is significantly faster than the peer agency average of 9 days. However, this is balanced by the fact that PEBA does not offer a benefit calculator linked to a member's salary and service data on the PEBA website.

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CEM identified several areas where PEBA does not include information on the pension statement that would be valuable to members: how their pension is inflation protected and opportunities for the member to increase the value of their pension such as purchasing service credit or the impact of working longer.

**Recommendation 8.16: PEBA should consider adding additional information to member statements to help them better understand their future options.**

## **Insurance Customer Service**

**Conclusion 8.17: Based upon a review of third party provider contracts, PEBA appears to effectively include service level performance agreements in its contracts for insurance services.**

We reviewed several recent contracts with insurance providers, including the pharmacy benefit manager (PBM). In those contracts, PEBA has included customer service performance requirements for areas such as timeliness of care or services, member account services, claims processing, call center responsiveness, and written communications.

Most contracts require quarterly reporting to PEBA of actual performance against those requirements and also typically have financial penalties for failure to meet the required standard. We did identify examples where penalties were paid for falling below the performance standard.

While the contracts and reports we reviewed indicate that PEBA does consistently include customer service and other performance standards in their contracts, we did not identify any policies which would provide guidelines to the insurance or procurement managers negotiating the contracts as to what minimum performance standards should be. In addition, there did not appear to be a single department or individual responsible for monitoring the performance of the external providers and reporting potential issues to PEBA leadership.

**Recommendation 8.17: PEBA should determine if assigning responsibility for monitoring insurance customer service to a single manager in the insurance organization could help focus the reporting and provide helpful input during contract negotiations.**

## **9. RECORD KEEPING AND SECURITY OF INFORMATION**

### **9.1 Scope of Review**

Our review evaluated the reasonableness and adequacy of PEBA's recordkeeping, and information security policies and practices. The review addressed the following specific areas:

1. Records management and retention policies and procedures
2. Disaster recovery plans and testing of business process units in conjunction with information systems business continuity activities
3. System security of significant business unit applications as it relates to the granting, changes to and revoking of access privileges
4. Policies and procedures relating to information security.

In addition, FAS reviewed the process for monitoring exceptions and the notification process for addressing identified issues.

### **9.2 Standard for Comparison**

We conducted interviews with numerous internal PEBA staff as well as several members of PEBA's benefit service providers and third-party administrators in order to understand any history of errors or processing problems. We also reviewed correspondence and documentation of PEBA's IT policies and procedures as they related to information protection, record retention and business continuity. We also utilized our review team's experience and knowledge of industry practices.

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### **9.3 Summary of Communications Conclusions**

**Conclusion 9.1: Retirement and Healthcare Benefits data and records management practices remain siloed. Separate member databases are maintained potentially leading to degradation of data integrity and an increase in data processing errors.**

**Conclusion 9.2: PEBA has established reasonable and appropriate data and network security protection policies and procedures. No significant data breaches were noted by PEBA or its third-party benefit program service providers during the past year during the course of our assessment. However, several improvement opportunities were identified to enhance PEBA's benefit program training to improve compliance with HIPAA regulations and network security.**

**Conclusion 9.3: No system outages or interruption of benefit processing were identified. There are a number of business recovery improvement opportunities.**

**Conclusion 9.4: No material data integrity issues were identified. Several control improvement opportunities exist.**

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## **9.4 Findings and Recommendations for each Communications Conclusion**

### **Background**

PEBA's record keeping and information security and privacy practices have been modeled after the State of South Carolina's Department of Archives as well as the Division of Technology. These policies and procedures have been customized by PEBA to ensure compliance with state requirements and cover the following areas: information security; general record keeping functions; and record retention and electronic records including data, email and electronic signatures.

PEBA completed a comprehensive records inventory in July 2012, which identified key documents, retention periods and referenced policies maintained by the business units as well as PEBA's IT department. It was noted during the course of our interviews that at the time of the merger, the Insurance Benefits group maintained their systems within another State of South Carolina program.

These systems and underlying technology were brought in-house during the middle of 2014. Although the transfer of systems, data and technology was successful, the systems themselves are not fully integrated and consequently, contained siloed data and information.

Third-party administrators are contractually obligated to maintain beneficiary data and records under the same state guidelines as PEBA. In addition, data that is obtained in serving PEBA's employers and beneficiaries is provided to PEBA via secure file transfer procedures. These file transfers are monitored for completeness and accuracy by both electronic edit checks as well as manual balancing procedures within the various business units.

In addition, vendors using PEBA systems are required to use the same access authentication and approval process as PEBA staff; ensuring accountability and appropriateness of access to beneficiary data. Any errors, data access or integrity issues are communicated to the service provider for follow-up and corrective actions.

PEBA's 32 full-time IT staff are responsible for developing and maintaining all of PEBA's application systems, network and computer infrastructure and information security. In addition, the department also works with each of the business functions to facilitate information and data transfers with third-party vendors and the State of South Carolina's Division of Technology.

PEBA has recently updated and enhanced their Information Security Policies and Procedural manuals to include:

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|                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>• Audit Controls</li><li>• Data Backup</li><li>• Designation of Security Officer and Security Administrator</li><li>• Disposal and Destruction of Data</li><li>• Emailing Data</li><li>• Evaluation</li><li>• Faxing Data</li><li>• Information Access Management</li><li>• Information System Activity Review</li></ul> | <ul style="list-style-type: none"><li>• Integrity</li><li>• Log in Monitoring</li><li>• Password Management</li><li>• System Access Authentication</li><li>• Physical Security Safeguards</li><li>• Sanction Policy</li><li>• Data Security Incidents</li><li>• Data Transmission Security</li><li>• Workforce Onboarding</li><li>• Workstation Use and Security</li></ul> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

PEBA's IT Information Security Policies and procedural manuals contain easily understood policy descriptions along with procedures on how they should be used on a day to day basis. They also reference regulatory requirements, i.e., Health Insurance Portability and Accountability Act (HIPAA).

PEBA's IT Department has dedicated staff to maintain and monitor its computer systems and networks. PEBA utilizes network intrusion monitoring software as well as conducts an annual network penetration test, using a nationally recognized third-party consulting firm. During its most recent Information Security Vulnerability Assessment, tests were conducted of both PEBA's external and internal computer networks.

The results of the tests, identified a total of eleven (11) different vulnerabilities, including two (2) high, one (1) medium and eight (8) low severity vulnerabilities. The assessment went on to state that the High risk vulnerabilities identified during the assessment were communicated to PEBA's network team.

PEBA currently has a documented data center recovery plan. This type of plan is primarily a data and technology center recovery plan. It does not include the recovery of all primary PEBA business functions, processes and relocation of staff and support personnel in the event that its primary business facilities are unavailable for an extended period of time. However, it does contain PEBA's record retention procedures for managing and recovery data and records that have been stored at the State's archive facilities.

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**Conclusion 9.1: Retirement and Healthcare Benefits data and records management practices remain siloed. Separate member databases are maintained potentially leading to degradation of data integrity and an increase in data processing errors.**

Since PEBA's inception in 2012, each of its primary benefit programs have been run within organizational and technology siloes. These organizational, business process workflow and information system siloes create a number of inefficiencies and potential sources for data and information processing errors. Although PEBA's current information technology infrastructure is adequate, long term sustainability of key systems and applications is considered a high risk. PEBA's underlying technology and computer applications for supporting its Retirement and Health benefit programs have not changed significantly since they were first developed (in some cases over 25 years ago).

From the standpoint of system sustainability, PEBA's primary systems were developed during a period of time that the computer language known as "Natural" was commonly used. However, since that time, other computer languages have been introduced that offer more functionality and are taught in more colleges and universities.

Consequently, the computer languages used in PEBA's benefit applications, are becoming more difficult to support. This is due to the retirement of existing PEBA programming staff as well as the declining number of application developers with this particular skillset in the local market. In addition, siloed business processes do not take advantage of natural efficiencies of common workflow activities, member data elements and consistent application of internal data and business process controls.

**Recommendation 9.1: PEBA should continue its efforts to conduct a comprehensive assessment of its operational infrastructure and business processes.**

**Conclusion 9.2: PEBA has established reasonable and appropriate data and network security protection policies and procedures. No significant data breaches were noted by PEBA or its third-party benefit program service providers during the past year during the course of our assessment. However, several improvement opportunities were identified to enhance PEBA's benefit program training to improve compliance with HIPAA regulations and network security.**

During the course of our interviews with PEBA's Board, staff and largest third-party benefit program service providers, no data breaches were noted during the past year. However, during that period a vendor's password protected laptop was stolen. PEBA implemented the legally required steps to investigate the incident and notify affected members, advising them of steps

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to take in protecting against potential identity theft and credit monitoring, demonstrating a robust process. It also terminated the subcontractor that caused the breach. This incident is further documented in Section 7.3 of this report.

PEBA utilizes network intrusion monitoring software. It also conducts annual network penetration tests, using nationally recognized third-party consultants. During its most recent Information Security Vulnerability Assessment, tests of both PEBA's external and internal computer networks were performed.

The tests identified a total of eleven (11) different vulnerabilities, including two (2) high, one (1) medium and eight (8) low severity vulnerabilities. The assessment went on to state that the High risk vulnerabilities identified during the assessment were communicated to PEBA's network team who proactively addressed a number of issues noted.

**Recommendation 9.2: PEBA should continue to conduct annual network and security vulnerability tests to ensure its networks and other infrastructural processes are working as intended. Greater use should be made of in-house based security monitoring tools to identify and protect its networks from unauthorized access and unintentional disclosure of member data.**

**Conclusion 9.3: No system outages or interruption of benefit processing were identified. There are a number of business recovery improvement opportunities.**

PEBA currently has a documented data center recovery plan. However, the current plan has not been updated to reflect current Retirement and Insurance businesses processes that have been merged into PEBA since its last review. Internal Audit conducted a review of information security during August, 2013. Among other findings in the report it noted the need to perform an updated Business Impact Analysis. It also noted the need to add additional backup power generation capabilities to support PEBA's primary offices in the event of a power failure. PEBA personnel also have not been trained in procedures that would need to be performed in the event that IT needed to activate its data center recovery plan and procedures.

**Recommendation 9.3.1: PEBA should address identified business continuity planning deficiencies.**

**Recommendation 9.3.2: PEBA should develop and implement a training program for business unit staff in the event the data center recovery plan has to be activated.**

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**Conclusion 9.4: No material data integrity issues were identified. Several control improvement opportunities exist.**

Over the past several years, there have been some errors or timeliness of monitoring activities over outstanding checks in the unclaimed property account, the deferral elections per the third-party administrator's website, contribution limits and defaulted loans. Although not material in dollar amount to the financial statements or quantity of errors, PEBA's staff understands the need to reduce sources of potential errors and has been working with its third-party administrators in correcting the problems.

**Recommendation 9.4: PEBA should continue its efforts to address the deferred compensation control procedural deficiencies noted by PEBA's staff. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance audit to determine that the control enhancements address the specific concerns noted.**

## **10. COST OF OPERATIONS**

### **10.1 Scope of Review**

The cost of operations assessment evaluated the reasonableness and adequacy of PEBA's cost of operations for the Retirement System and employee insurance benefit programs. The review addressed the following specific topics:

1. Benchmark comparisons
2. Costs per member/per assets/per program
3. Trends and reasonableness of costs

### **10.2 Standard for Comparison**

We utilized internal interviews, a review of documents and financial reports, a new PEBA benchmarking survey designed and conduct specifically for this review, and our review team's experience.

In addition, we utilized the most recent CEM Pension Administration Benchmarking report and its findings as a key data source. FAS contracted with CEM to provide additional input and analysis to the FAS review team based upon its most recent report.

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### **10.3 Summary of Cost of Operations Conclusions**

**Conclusion 10.1:** PEBA's pension administration activity costs are lower than their peers in nearly every activity and declined over 25% since 2009 on a per member and annuitant basis.

**Conclusion 10.2:** Based upon FAS' benchmarking study of other retirement administration agencies similar to PEBA, PEBA's overall headcount, normalized for retirement members and healthcare subscribers, is somewhat less than the median of the peer group.

**Conclusion 10.3:** Based upon FAS' benchmarking study, PEBA's Health and Insurance headcount is at the median for the peer group.

**Conclusion 10.4:** Based upon Retirement System annual financial reports, since the formation of PEBA in 2012 operating costs and professional and consulting fees for the retirement system have significantly declined.

**Conclusion 10.5:** PEBA's insurance operation costs have remained fairly constant over the past five years.

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## **10.4 Findings and Recommendations for each Cost of Operations Conclusion**

### **Background**

PEBA participates in the CEM Benchmarking Defined Benefit Administration Benchmarking Analysis Study. The most recent study report covered the 2013 fiscal year and was presented to PEBA in March 2014. In the study, PEBA's costs and service levels were compared to those of fourteen peer state public pension funds with membership of active members and annuitants ranging from 270,000 to 539,000, as compared to PEBA's 406,000.

Since the majority of PEBA's operating costs (nearly 60%) are related to retirement system administration and the CEM study is considered the leading independent cost and customer service comparison for U.S. state pension administration agencies, we have relied extensively on the CEM findings and analysis for this section of our audit. CEM also was subcontracted to FAS for this audit to provide additional analysis and insights concerning the FY2013 study.

We also conducted a custom peer benchmarking survey with other U.S. retirement agencies and collected information about headcount in each functional area as an additional input for retirement operations and to develop a baseline for insurance resource deployment.

Finally, we also examined the costs reported in the retirement system and insurance program annual reports since fiscal year 2009 to develop an additional source on cost information and to examine cost trends, particularly since the formation of PEBA in 2012.

### **Conclusion 10.1: PEBA's pension administration activity costs are lower than their peers in nearly every activity and declined over 25% since 2009 on a per member and annuitant basis.**

According to the CEM analysis, the PEBA pension administration cost per active and annuitant member in FY2013 was \$35.46 compared to an average peer group cost of \$76.13. PEBA was the lowest cost in the peer group. At the summary level, PEBA was well below the average peer cost in all areas compared by CEM: member transactions, member communication, collections and data maintenance, governance and financial control, major projects, information technology, and support services.

CEM analyzed the reasons for PEBA's pension administration costs to be over \$40 per member lower than the peer group average and calculated the following variances:

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**Table 15 Pension Administration Cost Comparison**

| Reason for lower PEBA cost                                                                | PEBA per member cost higher/ (lower) than peers |
|-------------------------------------------------------------------------------------------|-------------------------------------------------|
| Lower costs per FTE for: salaries and benefits, building and utilities, HR and IT desktop | \$(14.16)                                       |
| Major projects                                                                            | (7.32)                                          |
| IT strategy, database, applications (excl. major projects)                                | (5.79)                                          |
| Lower third-party and other costs in front-office activities                              | (5.35)                                          |
| Actuarial, legal, audit, other support services                                           | (3.47)                                          |
| Lower transactions per member (workloads)                                                 | (2.71)                                          |
| Governance and financial control                                                          | (1.83)                                          |
| Economies of scale advantage                                                              | (0.81)                                          |
| Slightly lower transactions per FTE (productivity)                                        | 0.78                                            |
| Total                                                                                     | \$(40.67)                                       |

About two-thirds of the difference, or \$27.27, is related to what could be considered internal staffing and infrastructure-related costs – lower per employee compensation and facility costs (\$14.16), major projects (\$7.32) and IT (\$5.79). It is not due to higher levels of productivity, which CEM defines as the number of member transactions completed per FTE (full time equivalent staff). In fact, PEBA productivity is slightly lower than average for the peer group. It should also be noted that PEBA reported no spending in 2013 for major projects.

Some of the contributing factors to PEBA's lower pension administration costs are lower governance and financial control costs (41% lower than the peer average) and lower actuarial, legal, audit and other support services costs (52% lower than the peer average). These back office costs were lower despite PEBA's plan design complexity score which is higher than the peer average. For plan design complexity, CEM found that PEBA has more pension payment options than the peer average, has multiple benefit formulas and offers a DC plan. Higher plan design complexity usually impacts the back-office costs.

**Recommendation 10.1: PEBA should review its focus on low cost of retirement operations and ensure there is an adequate level of investment in infrastructure to continue to provide a high level of customer service.**

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**Conclusion 10.2:** Based upon FAS' benchmarking study of other retirement administration agencies similar to PEBA, PEBA's overall headcount, normalized for retirement members and healthcare subscribers, is somewhat less than the median of the peer group.

As shown in the table below, with the exception of Employer Services and Finance and Accounting, PEBA is at or near the median of the peer group for headcount in most departments. However, Employer Services and Finance and Accounting appear to be staffed at a level less than half the peer median.

**Table 16 Headcount Comparison with Peer Agencies (Source: 2014 FAS Retirement Administration Agency Peer Benchmarking Results)**

| Function                                                           | Number of Employees |       |        |      |
|--------------------------------------------------------------------|---------------------|-------|--------|------|
|                                                                    | Low                 | High  | Median | PEBA |
| Retirement Administration FTEs per 100,000 DB Members              | 2.7                 | 122.2 | 17.5   | 17.5 |
| Health & Insurance FTEs per 100,000 Lives Covered *                | 0.0                 | 22.5  | 7.4    | 7.4  |
| Member Services FTEs per 100,000 DB Members + Lives Covered *      | 68.2                | 261.1 | 75.0   | 72.9 |
| Employer Services FTEs per 1,000 Employers                         | 0                   | 24.3  | 6.2    | 2.7  |
| IT FTEs per 100,000 DB Members                                     | 3.4                 | 32.3  | 9.3    | 9.3  |
| Legal FTEs per 100,000 DB Members                                  | 0.3                 | 11.2  | 1.7    | 2.1  |
| Finance and Accounting FTEs per 100,000 DB Members + Lives Covered | 3.0                 | 22.8  | 8.5    | 3.5  |
| Total FTEs per 100,000 DB Members                                  | 49.1                | 265.0 | 66.5   | 66.5 |
| Total FTEs per 100,000 DB Members + Lives Covered *                | 25.7                | 164.0 | 39.2   | 30.0 |

\* Excludes two agencies which do not administer health insurance

**Recommendation 10.2:** PEBA should determine if current headcount is adequate in all areas.

**Conclusion 10.3:** Based upon FAS' benchmarking study, PEBA's Health and Insurance headcount is at the median for the peer group.

As shown in the table above, PEBA's Health and Insurance headcount, at 7.4 per 100,000 lived covered, is the median for the peer group. The level of staffing seems reasonable.

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**Conclusion 10.4: Based upon Retirement System annual financial reports, since the formation of PEBA in 2012 operating costs and professional and consulting fees for the retirement system have significantly declined.**

Based upon an analysis of South Carolina Retirement System annual financial statements from FY2009 through FY2014, Administrative Expenses and Professional and Consultant Fees declined over 8% since the formation of PEBA in 2012 and 35% since a peak in FY2010.

**Table 17 Retirement System Historical Expense Comparison**

| Retirement System Expenses                                                                                                                                                                                  | Expenses \$(000) for Fiscal Year: |                  |                  |                  |                  |                  |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|------------------|------------------|------------------|------------------|------------------|
|                                                                                                                                                                                                             | 2009                              | 2010             | 2011             | 2012             | 2013             | 2014             |
| Wages and Benefits                                                                                                                                                                                          | \$ 11,627                         | \$ 11,860        | \$ 11,767        | \$ 11,765        | \$ 11,992        | \$ 10,260        |
| Contractual Services                                                                                                                                                                                        | \$ 3,338                          | \$ 4,783         | \$ 2,233         | \$ 1,755         | \$ 1,661         | \$ 1,966         |
| Operating Expenses                                                                                                                                                                                          | \$ 2,037                          | \$ 2,015         | \$ 1,928         | \$ 2,070         | \$ 1,492         | \$ 1,002         |
| Miscellaneous Expenses                                                                                                                                                                                      | \$ 450                            | \$ 312           | \$ 380           | \$ 51            | \$ 115           | \$ 225           |
| <b>Total Administrative Expenses</b>                                                                                                                                                                        | <b>\$ 17,452</b>                  | <b>\$ 18,970</b> | <b>\$ 16,308</b> | <b>\$ 15,641</b> | <b>\$ 15,260</b> | <b>\$ 13,453</b> |
| Professional and Consultant Fees                                                                                                                                                                            | \$ 3,185                          | \$ 3,009         | \$ 2,389         | \$ 1,562         | \$ 1,552         | \$ 1,399         |
| <b>Total Administrative Expenses and Professional and Consultant Fees</b>                                                                                                                                   | <b>\$ 20,637</b>                  | <b>\$ 21,979</b> | <b>\$ 18,697</b> | <b>\$ 17,203</b> | <b>\$ 16,812</b> | <b>\$ 14,852</b> |
| Retirees                                                                                                                                                                                                    | 119,820                           | 124,286          | 128,451          | 141,681          | 148,607          | 152,978          |
| Inactive Members                                                                                                                                                                                            | 169,590                           | 171,661          | 171,493          | 164,353          | 167,368          | 170,974          |
| Active Employees                                                                                                                                                                                            | <u>232,141</u>                    | <u>231,858</u>   | <u>229,592</u>   | <u>224,412</u>   | <u>223,286</u>   | <u>224,533</u>   |
| <b>Total Members</b>                                                                                                                                                                                        | <b>521,551</b>                    | <b>527,805</b>   | <b>529,536</b>   | <b>530,446</b>   | <b>539,261</b>   | <b>548,485</b>   |
| <b>Admin. Expense and Cons. Fees Per:</b>                                                                                                                                                                   |                                   |                  |                  |                  |                  |                  |
| Retired and Active Member                                                                                                                                                                                   | \$ 58.63                          | \$ 61.71         | \$ 52.22         | \$ 46.99         | \$ 45.21         | \$ 39.34         |
| Retired, Inactive and Active Member                                                                                                                                                                         | \$ 39.57                          | \$ 41.64         | \$ 35.31         | \$ 32.43         | \$ 31.18         | \$ 27.08         |
| <b>Notes:</b>                                                                                                                                                                                               |                                   |                  |                  |                  |                  |                  |
| 1. Data obtained from Retirement System Annual Financial Reports                                                                                                                                            |                                   |                  |                  |                  |                  |                  |
| 2. Prior to FY2014, PEBA recorded RSIC administrative costs as a PEBA Operating Expense. Based upon GASB 67, PEBA changed its accounting policy to record this as an investment expense starting in FY2014. |                                   |                  |                  |                  |                  |                  |
| RSIC Administrative Cost adjustment                                                                                                                                                                         | \$ (3,699)                        | \$ (3,812)       | \$ (4,919)       | \$ (6,768)       | \$ (7,041)       | \$ -             |

In 2009, using their propriety methodology, CEM had calculated pension administration costs at PEBA's predecessor organization to be \$49 per active and annuitant member, or 38 percent higher than the 2013 cost of \$35.46. During this period the average cost of PEBA's peer group increased by 0.4 percent annually while PEBA's declined 7.7 percent on average per year.

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PEBA's apparent focus on cost reduction seems to have been successful and is admirable. In addition, it should be noted that PEBA had an extremely high number of staff vacancies during the first two years of operation that resulted in a lower than normal wage and benefit costs.

**Recommendation 10.4:** To achieve PEBA's stated strategies of further integration and improved infrastructure, it should request at least a temporary increase in administrative expenses and professional and consulting fees for several years.

**Conclusion 10.5:** PEBA's insurance operation costs have remained fairly constant over the past five years.

We analyzed the reported operating expenses in the insurance program annual reports from fiscal years 2009 through fiscal year 2013 and obtained the draft fiscal year 2014 reports. As shown in the table below, health insurance operating expenses have increased slightly (7% over five years) since 2009 and remained flat on a per insured person basis.

**Table 18 Health Insurance Historical Expense Comparison**

| Health Insurance Expenses                                         | Expenses \$(000) for Fiscal Year: |                 |                  |                 |                 |                  |
|-------------------------------------------------------------------|-----------------------------------|-----------------|------------------|-----------------|-----------------|------------------|
|                                                                   | 2009                              | 2010            | 2011             | 2012            | 2013            | 2014             |
| Salaries and Benefits                                             | \$ 5,364                          | \$ 5,442        | \$ 5,472         | \$ 5,123        | \$ 5,686        | \$ 6,785         |
| Other Services                                                    | \$ 2,628                          | \$ 2,738        | \$ 2,709         | \$ 2,725        | \$ 2,326        | \$ 1,722         |
| Professional Services                                             | \$ 578                            | \$ 736          | \$ 765           | \$ 799          | \$ 626          | \$ 492           |
| Adoption Assistance Program                                       | \$ 495                            | \$ 300          | \$ 700           | \$ 250          | \$ 271          | \$ 293           |
| Supplies                                                          | \$ 158                            | \$ 271          | \$ 128           | \$ 216          | \$ 127          | \$ 285           |
| Telephone and Utilities                                           | \$ 107                            | \$ 105          | \$ 124           | \$ 71           | \$ 113          | \$ 80            |
| Other Operating Expenses                                          | \$ 308                            | \$ 304          | \$ 176           | \$ 351          | \$ 383          | \$ 669           |
| <b>Total Operating Expenses</b>                                   | <b>\$ 9,638</b>                   | <b>\$ 9,896</b> | <b>\$ 10,074</b> | <b>\$ 9,535</b> | <b>\$ 9,532</b> | <b>\$ 10,326</b> |
| Active Employees                                                  | 179,321                           | 176,902         | 173,561          | 174,628         | 174,937         | 179,590          |
| Total Subscribers                                                 | 248,467                           | 249,113         | 248,682          | 252,065         | 254,363         | 260,342          |
| Total Insured Persons                                             | 426,424                           | 428,792         | 436,794          | 440,966         | 443,731         | 456,993          |
| <b>Operating Expense Per:</b>                                     |                                   |                 |                  |                 |                 |                  |
| Active Employee                                                   | \$ 53.75                          | \$ 55.94        | \$ 58.04         | \$ 54.60        | \$ 54.49        | \$ 57.50         |
| Subscriber                                                        | \$ 38.79                          | \$ 39.72        | \$ 40.51         | \$ 37.83        | \$ 37.47        | \$ 39.66         |
| Insured Person                                                    | \$ 22.60                          | \$ 23.08        | \$ 23.06         | \$ 21.62        | \$ 21.48        | \$ 22.60         |
| Notes:                                                            |                                   |                 |                  |                 |                 |                  |
| 1. Data obtained from insurance Benefits Annual Financial Reports |                                   |                 |                  |                 |                 |                  |

However, based upon the need to receive bids on multiple new insurance contracts over the next few years and the Board's interest in pursuing health insurance innovation, PEBA has a

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need for more resources, both internal and external, to develop a longer-term health insurance strategy and plan. The creation of the new Health Care Policy Director position should be a good first step in this direction.

**Recommendation 10.5: PEBA should increase its budget for health insurance strategy development and planning.**

## **11. INFORMATION TECHNOLOGY SYSTEMS**

### **11.1 Scope of Review**

We evaluated the reasonableness, adequacy, and security of PEBA's information technology systems and availability of tools and resources for PEBA Board of Directors, staff and fiduciaries to effectively administer the assets and funds of the Retirement System, Insurance programs and non-retirement benefit plans.

The review addressed the following topics:

1. Adequacy of operational, risk management, accounting and compliance systems, tools and resources for the needs of PEBA
2. Existing IT policies, charters, internal audit reports and organizational charts
3. Controls and procedures that are being relied upon for accurate, complete and timely information and reporting
4. Day-to-day operations of the data center, application development and maintenance, information security and network operations

### **11.2 Standard for Comparison**

We utilized internal interviews, review of key documents, and our review team's experience and knowledge of industry practices to complete this assessment.

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### **11.3 Summary of Information Technology Systems Conclusions**

**Conclusion 11.1:** PEBA has effective information technology systems at present. Long-term system support and development will be hampered due to an aging infrastructural environment.

**Conclusion 11.2:** PEBA's Internal Audit department has conducted audits of the Information Technology department and related business processes according to its Board-approved plan. The results of the completed audits, including improvement opportunities, have been properly communicated to PEBA's staff and Board.

**Conclusion 11.3:** PEBA's use of independent Certified Public Accounting firms to conduct financial audits of their financial statements as well as disclosures made within the Comprehensive Accounting Financial Report did not identify any significant accounting or internal control related issues.

**Conclusion 11.4:** PEBA does not have a comprehensive Information Technology Strategic Plan. PEBA's existing IT Plan consists of a one year outlook with budget considerations. It does not contain any references to specific PEBA long term directional business strategies or multi-year initiatives.

**Conclusion 11.5:** PEBA's IT Operational and Risk Management practices appear effective. However, further efforts need to be made to move from a data center disaster recovery plan orientation to an enterprise wide business continuity focused plan.

**Conclusion 11.6:** The Information Technology department's organizational structure has historically been able to adequately maintain the existing systems and infrastructure. As PEBA continues to merge its legacy applications and business process, it will be challenged by the underlying and aging program languages used to originally develop them. It will also become increasingly difficult to replace the knowledge and programming language skills of employees who will retire over the next five years.

**Conclusion 11.7:** PEBA's Internal Audit department's assessment of Information Technology risks appears reasonable based on current industry trends and events but improvement opportunities exist.

**Conclusion 11.8:** PEBA's business process and IT controls for identifying, correcting errors and ensuring completeness of reporting appear reasonable. Further improvements should be considered.

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**Conclusion 11.9: PEBA Board and staff members were very complimentary of the quality and timeliness of the services they obtain from the department in their comments to us during this review but there is no formal IT customer satisfaction tracking.**

**Conclusion 11.10: PEBA's information system development and project management methods appear to be sound.**

**Conclusion 11.11: PEBA's information security policies and procedures appear to be effective. Improvements can still be made.**

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## **11.4 Findings and Recommendations for each Information Technology Systems Conclusion**

### **Background**

PEBA's Information Technology Department consists of 32 full-time staff members and resides within the Administration Department under the Chief Operating Officer. We understand that under the recently announced reorganization, IT now reports directly to the Chief Operating Officer.

PEBA's Information Technology policies and procedures have been developed based on established guidelines set forth by the State of South Carolina's Division of Technologies. In addition, the IT department has developed and implemented policies in all key areas of its responsibilities, i.e., Computer Operations, Information Security, Database Management, Infrastructure, Application Development and Maintenance as well as Disaster Recovery.

Information Technology is responsible for developing and maintaining all of PEBA's application systems, network and computer infrastructure and information security. In addition, the department also works with each of the business functions to facilitate information and data transfers with third-party vendors and the State of South Carolina's Division of Technology.

The data center is located within one of PEBA's main office locations, while their programming and support staff are located at both facilities. In addition, PEBA has contracted with a nationally recognized data center recovery firm to support them in the event of an extended data center outage. Testing of PEBA's data center recovery plans takes place once a year, which allows them to test their recovery procedures and systems, in order to continue to serve their retirement and insurance beneficiaries.

PEBA's staff recognize the need to expand their existing data center recovery processes to incorporate a business wide recovery plan. The plans should take into consideration a wider range of potential events that might prevent other key business functions from operating at their current locations and levels of service.

Prior to June of 2014, PEBA's Information Technology group primarily supported the Retirement Benefits systems. Insurance Benefits was supported by another State agency.

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These systems include:

**Table 19 Current Major PEBA Application Systems**

| Retirement Benefit Systems                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Insurance Benefit Systems                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Enrollment of members</li> <li>• Reporting of Employee and Employer contributions</li> <li>• Retirement Claim processing <ul style="list-style-type: none"> <li>– Claims Refund</li> <li>– Death Claims benefits</li> <li>– Retirement Claims</li> </ul> </li> <li>• Payment Management System</li> <li>• Service Purchase System</li> <li>• Installment Service Purchase System</li> <li>• Online Members Access System</li> <li>• Online Employer Information System</li> <li>• Financial Accounting Systems – SAP ECC6</li> </ul> | <ul style="list-style-type: none"> <li>• Legacy – primary source for all enrollment records</li> <li>• MyBenefits – web-based enrollment system used by subscribers</li> <li>• EBS – web-based enrollment system used by participating employers</li> <li>• Utility Tool – web-based system used by staff to approve/reject “paperless” (EBS created/MyBenefits approved) enrollment transactions</li> <li>• Puddles – web-based tool used by staff to review each step an enrollment transaction</li> <li>• EIPNET – web-based repository of reports</li> <li>• Financial Accounting System – Custom developed using Ruby programming language</li> </ul> |

Note: Unless otherwise noted, systems were written in Natural and Java programming languages.

During the past two years, there have not been any significant special projects other than focusing on bringing in-house the Insurance systems as well as implementing a new retirement enrollment system. This lack of investment in replacing technology or systems has contributed to PEBA’s low cost provider benchmarks.

However, it has also resulted in unintended consequences such as strategic infrastructure decisions being deferred and potentially higher, long term maintenance costs being incurred. We noted that while certain technology integration has occurred with bringing in-house the Insurance systems, PEBA still maintains two separate member databases and business processes.

PEBA’s Board and staff recognize the inefficiencies created by maintaining separate business processes and underlying systems. Consequently, PEBA has undertaken initial steps to conduct a comprehensive Operational Systems Assessment.

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## **Operational Systems Assessment**

The proposed Operational Systems Assessment is intended to review PEBA's current business processes, and systems to determine synergies for a next-generation integrated system. The project is broken down into the following phases:

### **Operational Information Technology Systems Assessment Phase (Phase I)**

- Define High level business process mappings for all business processes ("*As Is*") within PEBA.
- Evaluate and define the current high level architecture of PEBA systems.
- Evaluate the current PEBA organizational structure, focus on staffing structure, capacity and capability levels.
- Develop Strengths, Weaknesses, Opportunity and Threats (SWOT) analysis

### **Future Design Phase (Phase II)**

- Define high level business process mappings ("*To Be*") of futuristic PEBA systems.
- Define high level architectural design for future PEBA systems.
- Evaluate and define a proposed future organizational structure.

### **Modernization Plan Phase (Phase III)**

- High Level Roadmap – Define a Program Management Office (Project Charters, Timelines, Budgets, Deliverables, etc.)
- Cost Benefit Analysis to determine benefits of implementing the projects.
- Final Assessment Report

The proposed new system would address integrating business functions, eliminate redundant databases and use modern language programs. The existing legacy programs use languages which are no longer taught in most universities.

PEBA's IT infrastructure challenges will become more significant as existing programming staff retire with institutional knowledge and specific programming language skills. Such skills are not easily replaced in the current marketplace. In addition to helping addressing infrastructural issues, the new system would allow PEBA to implement more quickly new benefit programs to support its member and beneficiaries. The initiative is intended to result in a multi-phased project that may cost approximately \$30 to \$50 million and will take a number of years to fully implement.

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## **IT Infrastructure**

**Conclusion 11.1: PEBA has effective information technology systems at present. However, long-term system support and development will be hampered by its aging infrastructure.**

Although PEBA's current information technology infrastructure is adequate, long term sustainability of key systems and applications is a high risk. PEBA's underlying technology and computer applications for supporting its Retirement and Health benefit programs have not changed significantly since they were first developed (in some cases over 25 years ago).

From the standpoint of system sustainability, PEBA's primary systems were developed during a period of time that the computer language known as "Natural" was commonly used. However, since that time, other computer languages have been introduced that offer more functionality and are taught in more colleges and universities.

Consequently, the computer languages used in PEBA's benefit applications, are becoming more difficult to support given the retirement of existing PEBA programming staff as well as the declining number of application developers with this particular skillset in the local market.

**Recommendation 11.1: PEBA should complete its comprehensive assessment of its existing IT infrastructure and business systems.**

## **Risk Management and Control**

**Conclusion 11.2: PEBA's Internal Audit department has conducted audits of the Information Technology department and related business processes according to its Board-approved plan. The results of the completed audits, including improvement opportunities, have been properly communicated to PEBA's staff and Board.**

Every five years, Internal Audit conducts an enterprise-wide risk assessment of PEBA's operational, risk management, accounting and compliance systems, tools and resources. It is supplemented by an annual refresh.

Internal Audit consists of an Internal Audit Manager and one staff position. Additional resources are contracted with third-party auditing and consulting firms. The Internal Audit manager prepares the results of the risk assessment and develops a corresponding Audit Plan, which is presented to the Finance, Accounting and Auditing Committee for review and approval. During the most recent year, Internal Audit has incorporated six information technology audits out of a total of 15 planned engagements.

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In addition to the audits conducted by PEBA's Internal Audit function, additional independent financial audits are conducted by CPA firms engaged by the State's Auditors' Office. These firms include CliftonAllenLarson LLP and Elliott Davis LLC.

These firms perform audits of PEBA's financial statements, CAFR and various employee benefit programs. As part of the independent CPA firm's financial audit procedures, they evaluate those internal controls over financial reporting and accounts that make up the financial statements. The results of their audits are presented to PEBA's Board and staff upon completion of their engagements.

Every five years Internal Audit conducts a detailed risk assessment by distributing questionnaires to each business function and conducting follow-up meetings to clarify responses and prioritize identified risks based on impact and likelihood. On an annual basis, Internal Audit refreshes its five-year risk assessment through interviews and meetings with PEBA's business units and Board members. As a result of this past year's assessment, Information Security was noted as being a high risk due to recent threats noted in other systems in the country. Consequently, Internal Audit planned and conducted three IT related audits. Findings were communicated in written reports to PEBA's staff and Board in compliance with its Charter and Policy. We did note that Internal Audit staffing consisted of two full time members, whereas similarly sized systems typically utilize between three and six full time equivalents.

**Recommendation 11.2: PEBA should increase the frequency of a full enterprise wide risk assessment to ensure that Internal Audit's Plan for the upcoming year reflects the most significant risks to the organization (see also Recommendations 2.7.1 and 2.7.2).**

### **Use of Independent Auditors**

**Conclusion 11.3: PEBA's use of independent Certified Public Accounting firms to conduct financial audits of their financial statements as well as disclosures made within the Comprehensive Accounting Financial Report did not identify any significant accounting or internal control related issues. Some internal control processes could be improved.**

PEBA's external financial auditors include: CliftonAllenLarson LLP and Elliott Davis LLC. These three firms perform audits of PEBA's financial statements, CAFR and various employee benefit programs. As part of the independent CPA firm's financial audit procedures, they only evaluate internal controls over financial reporting and accounts that make up the financial statements.

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On an annual basis, observations or concerns relating to the system's financial controls environment are communicated to PEBA's staff and Board. The communication of the observations or concerns are provided to help PEBA's staff and Board improve the internal control environment and do not represent the expression of an opinion on the internal controls.

**Recommendation 11.3: PEBA should continue its efforts to address the control procedural deficiencies noted by their external auditors. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance audit to determine that the control enhancements address the specific concerns noted.**

### **IT Strategic Plan**

**Conclusion 11.4: PEBA does not have a comprehensive Information Technology Strategic Plan. PEBA's existing IT Plan consists of a one year outlook with budget considerations. It does not contain any references to specific PEBA long term directional business strategies or multi-year initiatives.**

As part of PEBA's annual planning process the Information Technology department developed an Information Technology Strategic Plan for 2014. The plan was developed with input from each of PEBA's functional areas and outlines key objectives and quarterly cost estimates. Although, the plan discusses alignment with PEBA's strategic goals, the plan lacks clarity and detail of how it directly aligns to PEBA's overall strategic priorities. In addition, some costs were not fully estimated due to ongoing analyses that were taking place at the time the budget was prepared.

**Recommendation 11.4: After the Operational Systems Assessment is completed, the IT department should lead an effort to develop a long-term IT strategic plan which supports the plan infrastructure direction.**

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## **Business Continuity and Disaster Recovery**

**Conclusion 11.5: PEBA's IT Operational and Risk Management practices appear effective but plans could be more complete.**

PEBA currently has a documented data center recovery plan. Current plans have not been updated to reflect the current Retirement and Insurance businesses processes that have been merged into PEBA since its last review. The Business Impact Analysis noted in Internal Audit's report would be the basis for identifying and prioritizing all significant business processes, systems and logistics necessary to operate an off-site location for potentially, an extended period of time. PEBA personnel have not been trained in procedures that would need to be performed in the event that Information Technology needed to activate its data center recovery procedures.

**Recommendation 11.5: Further efforts need to be made to move from a data center disaster recovery plan orientation to an enterprise wide business continuity focused plan.**

## **IT Organization and Personnel**

**Conclusion 11.6: The Information Technology department's organizational structure has historically been able to adequately maintain the existing systems and infrastructure. As PEBA continues to merge its legacy applications and business process, it will be challenged by the underlying and aging program languages used to originally develop them. It will also become increasingly difficult to replace the knowledge and programming language skills of employees who will retire over the next five years.**

As previously described, PEBA's 32 full-time IT staff are responsible for developing and maintaining all of PEBA's application systems, network and computer infrastructure and information security. In addition, the department also works with each of the business functions to facilitate information and data transfers with third-party vendors and the State of South Carolina's Division of Technology.

In addition, PEBA's primary systems were originally developed over 25 years ago using a computer language known as "Natural." Although commonly used back then, other computer languages have been introduced that offer more functionality and are taught in more colleges and universities. Consequently, the computer languages used in PEBA's benefit applications are becoming more difficult to support given the retirement of existing PEBA programming staff as well as the declining number of application developers with this programming language in the local market.

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**Recommendation 11.6.1:** PEBA should continue to move forward with its plans to conduct a comprehensive IT Operations Assessment to identify common business process, technology and develop a roadmap to develop its next generation of systems to support the strategic direction of the organization.

**Recommendation 11.6.2:** PEBA should continue to assess potential third-party IT vendors which may be able to provide additional legacy “Natural language” programming support in the event a large number of existing PEBA programming staff retire or leave the organization.

**Conclusion 11.7:** PEBA’s Internal Audit department’s assessment of Information Technology risks appears reasonable based on current industry trends and events but improvement opportunities exist.

Internal Audit currently relies almost exclusively on external consultants to perform their Information Technology audits. Although outsourcing certain Internal Audit functions is common in this area, the final decisions on risk ranking and remediation efforts are still the responsibility of PEBA’s staff and Board. Having multiple sources of expertise associated with technology, industry and current events is important.

**Recommendation 11.7:** PEBA should continue to work closely with the State’s Information Sharing and Analysis Center (SC-ISAC) along with other third-party information technology consulting firms to proactively assess existing and trending threats to information and network security.

**Conclusion 11.8:** PEBA’s business process and IT controls for identifying and correcting errors and ensuring completeness of reporting appear reasonable. Some improvements should be considered.

Retirement and Insurance systems are supported by the Information Technology department to generate reports used to ensure data integrity and the completeness of transaction processing. These systems contain various edit checking activities consisting of 1) batch processing edit checks and exception reporting; 2) real-time data entry edits that prevent out of bounds data entry or incomplete data entry screens from further processing; or 3) manual balancing and reconciling of system output to other systems or third-party data sources.

When business units identify new sources of errors, IT projects are initiated to undertake a root cause analysis and corrective action report. The IT department works with the business units to

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recommend changes, add additional error checking logic, as well as any additional reporting features to ensure similar problems are eliminated.

Additional reporting or system change requests are discussed with the Information Technology liaison. Once approved for development, a formal process exists to develop, test and track and approve changes to the system. Status reports are discussed during bi-weekly meetings to promote transparency in communication and status.

PEBA's business units and IT representatives meet at least every other week to discuss any processing or system issues they are encountering. In addition, the business units obtain status updates on any open IT related projects. These projects usually involve new system functionality, corrective actions, minor enhancements or reporting. Based on feedback from numerous PEBA staff interviewed, communication between the business units and IT are very good. This conclusion was also supported by a recently obtained copy of IT's Help Desk Survey results as of December 10, 2014:

**Table 20 Help Desk Survey Results**

| Response                       | # of Responses | Percentage |
|--------------------------------|----------------|------------|
| Very Satisfied                 | 119            | 64.67%     |
| Satisfied                      | 41             | 22.28%     |
| Neutral                        | 6              | 3.26%      |
| Dissatisfied/Very Dissatisfied | 0              | -          |
| Not Completed or Not Displayed | 18             | 9.78%      |

However, it was unclear as to how data or processing issues identified by one business unit may impact other similar systems or workflow processes.

**Recommendation 11.8: Issues and error correcting processes should be shared across functional business units to ensure that similar errors in one beneficiary system are also being addressed in other similar application systems.**

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**Conclusion 11.9: PEBA Board and staff members were very complimentary of the quality and timeliness of the services they obtain from the department in their comments to us during this review but there is no formal IT customer satisfaction tracking.**

Although users generally seem satisfied with the services they receive from the IT Department, they did express unmet needs for better functionality of their systems. Leading practice is to have more formalized processes for understanding user satisfaction to better manage the IT function and processes.

**Recommendation 11.9: The Information Technology Department should consider developing a formal IT user satisfaction feedback process.**

**Conclusion 11.10: PEBA's information system development and project management methods appear to be sound.**

PEBA's IT department utilizes a comprehensive system development methodology. It incorporates formal request forms and approval processes for new projects as well as requests for system enhancements and functionality by the user departments. IT steering committees are used to review requests for approval and for monitoring the progress of all projects in process.

PEBA utilizes a project tracking application for maintaining the status of programming projects. Projects are reviewed on a bi-weekly basis with the respective user departments as well as within the IT organization for overall prioritization and resource management.

**Recommendation 11.10: As PEBA completes its Operational Systems Assessment, it should consider what, if any, additional methodologies and skills will be required for the Information Technology Department to effectively support a new IT plan.**

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**Conclusion 11.11: PEBA's information security policies and procedures appear to be effective. However, some improvements can be made.**

PEBA's IT Information Security Policies and procedural manuals contain easily understood policy descriptions along with procedures on how they should be used on a day to day basis. They also reference which regulatory requirements they address, i.e., Health Insurance Portability and Accountability Act (HIPAA).

PEBA has recently updated and enhanced their Information Security Policies and Procedural manuals to ensure comprehensive coverage of all aspects of information security:

**Table 21 Information Security Policy Areas**

|                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>• Audit Controls</li><li>• Data Backup</li><li>• Designation of Security Officer and Security Administrator</li><li>• Disposal and Destruction of Data</li><li>• Emailing Data</li><li>• Evaluation</li><li>• Faxing Data</li><li>• Information Access Management</li><li>• Information System Activity Review</li></ul> | <ul style="list-style-type: none"><li>• Integrity</li><li>• Log in Monitoring</li><li>• Password Management</li><li>• System Access Authentication</li><li>• Physical Security Safeguards</li><li>• Sanction Policy</li><li>• Data Security Incidents</li><li>• Data Transmission Security</li><li>• Workforce Onboarding</li><li>• Workstation Use and Security</li></ul> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

PEBA's IT Department has dedicated staff to maintaining and monitoring its computer systems and networks. PEBA utilizes network intrusion monitoring software as well as conducts annual network penetration tests, using nationally recognized third-party consultants. During its most recent Information Security Vulnerability Assessment, tests were conducted of both PEBA's external and internal computer networks. The results of the tests, identified a total of eleven (11) different vulnerabilities, including two (2) high, one (1) medium and eight (8) low severity vulnerabilities.

The assessment went on to state that the High risk vulnerabilities identified during the assessment were communicated to PEBA's network team who proactively addressed a number of issues noted.

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Internal Audit conducted a review of information security during August, 2013. The report did not identify any significant security policy or procedural concerns. However, it did note that several policies pertaining to information security, data classification as well as security roles and responsibilities needed to be developed. Since the review in 2013, PEBA developed specific policies and procedural manuals modeled after those developed by the State of South Carolina's Division of Technology. These policies and procedures were most recently updated in September 2014. However, other findings in the report noted the need to perform an updated Business Impact Analysis, as well as add additional backup power generation capabilities, to support more than just the data center's needs in the event of a power failure. During the course of our interviews, it was noted that PEBA has begun to address the remaining two items of Internal Audit's report.

**Recommendation 11.11: PEBA should continue its efforts to address its business continuity planning deficiencies.**

## **APPENDICES**

**Appendix A: PEBA Fiduciary and Governance Legal Issues**

**Appendix B: 2013 CEM Benchmarking Report Executive Summary**

**Appendix C: FAS Benchmarking Survey of PEBA Peers**

**Appendix D: Legal Compliance Requirements Applicable to PEBA's Plans**

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## Appendix A: PEBA Fiduciary and Governance Legal Issues

This Appendix was prepared by Reinhart Boerner Van Deuren s.c. to provide legal context for the Funston Advisory Services 2014 report on its fiduciary and governance review of the South Carolina Public Employee Benefit Authority (PEBA). As we are not South Carolina law experts, it is not a legal opinion and is not intended to constitute legal advice. Rather, this summary provides background for discussion of issues which are covered in the report. It addresses the following topics:

- Fiduciary duties applicable to PEBA Board Members and staff, including the high standards of conduct imposed by the duty of loyalty;
- PEBA's co-fiduciary obligations to monitor other officers and entities that also have fiduciary authority;
- Ambiguities inherent in South Carolina's complex and overlapping system of fiduciary authority and accountability;
- Implications of trust assets not being state funds; and
- Legal standards applicable to PEBA in managing insurance benefits.

### I. PEBA's Fiduciary Obligations

#### Trust Fund Fiduciary

PEBA Board Members are named fiduciaries of the Retirement System. S.C. Code Ann. § 9-1-1310. The legal duties imposed on as a result are set forth in S.C. Code Ann. § 9-16-40, which applies to all Retirement System fiduciaries. Those duties are:

*A trustee, commission member, or other fiduciary shall discharge duties with respect to a retirement system:*

- (1) solely in the interest of the retirement systems, participants, and beneficiaries;*
- (2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;*
- (3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;*
- (4) impartially, taking into account any differing interests of participants and beneficiaries;*

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- (5) *incurring only costs that are appropriate and reasonable; and*
- (6) *in accordance with a good faith interpretation of this chapter.*

There has been little guidance on application of these fiduciary standards from the South Carolina courts or Attorney General. However, the standards mirror common law trust fund fiduciary principles that are generally applicable to trustees at public pension funds across the United States and that provide guidance for interpretation of the Employees Retirement Income Security Act (ERISA) that cover private pension funds. Indeed, South Carolina adopted the description of fiduciary duties that is set forth in the Uniform Management of Public Employees Retirement Security Act (UMPERSA), which were derived from general trust law. See UMPERSA at p. 23. Accordingly, common law principles and discussion of fiduciary duties in UMPERSA likely provide guidance for application of PEBA's fiduciary duties. Several aspects of those duties are particularly relevant to PEBA's responsibilities.

### ***Duty of Loyalty Runs to Participants and Beneficiaries***

Trustees have a duty to act solely in the interest of beneficiaries of the trust and are strictly prohibited from engaging in transactions that involve or create a conflict of interest between the trustee's fiduciary duty to the beneficiaries and his or her personal interests. (See Restatement Third of Trusts § 78.) A trustee has a duty to not be influenced by the interests of any third person or by motives other than the purposes of the trust. (See *id.* at comment (f)). South Carolina has certified this duty in S.C. Code Ann. § 9-16-40, which states that PEBA member's fiduciary duties be discharged "solely in the interest of the retirement systems, participants, and beneficiaries."

For example, a board member's actions cannot be motivated to appease/benefit the taxpayers or the officer who appointed the board member to PEBA. A focus on serving taxpayer or political interests could be seen as a violation of S.C. Code Ann. § 9-16-40 and involve a conflict between the board member's personal interest in protecting his or her position on the PEBA board and interests of the Retirement System's beneficiaries. Indeed, as explained in the UMPERSA: "this duty [of loyalty] includes the obligation to set aside the interests of the party that appoints a trustee or fiduciary." UMPERSA at p. 23. Because PEBA board members have a duty to not be influenced by personal agendas or the interests of any third party; actions intended to benefit the taxpayers or an appointing authority over the interests of trust fund participants and beneficiaries could result in a breach of the duty of loyalty.

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Moreover, because appointed PEBA board members serve at the pleasure of their appointing authority under S.C. Code Ann. §9-4-10, they inherently face challenges of conflicting pressures. The member could be "exposed . . . to the temptation of considering interests other than those of the trust beneficiaries" which could cause a breach of the board member's duty of loyalty. (See Restatement Third of Trusts § 78, comment (e)). The temptation to overlook fiduciary obligations in favor of directives from the board member's appointing authority is ever present where an appointee may be removed from the PEBA board without cause at any time. By having PEBA board appointees serve at the pleasure of the appointing authority, the current statutory structure might even increase exposure to fiduciary liability by creating the automatic appearance of a conflict of interest.

### ***Duty of Care***

An overarching duty of all Trustees is to administer the Retirement System with the care, skill, and caution under the circumstances then prevailing that a prudent person in a like capacity and familiar with those matters would take. See S.C. Code Ann. § 9-16-40(3). It is this duty of care that supplies the standards by which to determine what is considered "prudent." The duty is an objective measure that compares the actions of the Trustee to a prudent person "in a like capacity and familiar with the matters" of the Retirement System. As such, Trustees are held to a higher standard than members of non-fiduciary boards.

### ***Duty of Impartiality***

PEBA Trustees have a duty under S.C. Code Ann. § 9-16-40 to administer the trust in a manner that is impartial with respect to the various beneficiaries. (See also Restatement Third of Trusts § 79). Impartial does not necessarily mean equal, but it does mean that a trustee's treatment of beneficiaries or conduct in administration of the trust should not be influenced by favoritism (or animosity) toward any individual beneficiary or group of beneficiaries. (See *id.* at comment (b)). Rather, trustees must balance beneficiaries' competing interests in a manner consistent with the beneficial with the terms and purposes of the trust. (See *id.* at comments (b) and (c)). Trustees must make "diligent and good faith efforts to identify, respect and balance" the varying beneficial interests under the trust. (See *id.* at comment (c)).

This also means that, even if a Trustee is appointed as a representative of a certain group of participants, once on the Board, the Trustee must consider and treat the interests of all participants and beneficiaries impartially. "[It] is as improper for a fiduciary to take actions for the purpose of benefiting a third person as it is for a fiduciary to act in its own interest. In the

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retirement setting, it is important to note that this duty includes the obligation to set aside the interests of the party that appoints a trustee or fiduciary." UMPERSA § 7 Comments.

Relatedly, Trustees have a duty to treat employees at different employers fairly and impartially. Again, Trustees are not obligated to treat all employees equally, but the duty of impartiality imposes limits on the Trustees' ability to divert trust assets to a set (or subset) of employers that would unreasonably benefit certain employees at the expense of other beneficiaries.

### **Strict Standard**

The fiduciary duties outlined above are stricter and more extensive than those applied to other public officials. Because of this objective, statutory standard, fiduciaries are often granted a level of independence not allowed for other public officials. The rationale for this is described in UMPERSA:

*[It] permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging (and possibly conflicting) set of interests.*

UMPERSA at pp. 16-17.

Moreover, pension Trustees are held to a higher standard of conduct than corporate directors. For example, the Trustees' duty of loyalty precludes them from any self-dealing or conflicts of interest, whereas corporate fiduciaries are generally permitted to enter into related-party transactions involving conflicts with appropriate disclosure. See Restatement Third of Trusts §§ 8 and 144 and S.C. Code Ann. § 33-8-310 ("A conflict of interest transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true: (1) the material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors, and the board of directors or a committee authorized, approved, or ratified the transaction; (2) the material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or (3) the transaction was fair to the corporation.").

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### II. Co-Fiduciary Oversight Obligations

Concerns have been raised as to what fiduciary obligations PEBA has if the State Treasurer failed to timely release funding for an investment manager duly approved by the statutorily-designated fiduciary with sole investment authority or failed to observe statutory duties for the trust funds. In short, as a named fiduciary, PEBA would have common law obligations to take reasonable actions to prevent or respond to an apparent co-fiduciary breach.

Even where the Treasurer believes he is doing the right thing, case law suggests that a fiduciary can unintentionally violate its duty of loyalty when subjectively acting with good intentions and in accordance with his individual view of what fiduciary responsibilities require. (*See e.g.*, Fletcher Cyclopedia of the Law of Corporations § 837.60 (2010 Ed.); *In Re Mony Group, Inc. Shareholder Lit.*, 853 A.2d 661 (Del. Ch. 2004); *Esophs Creek Value Lp v. Hauf*, 913 A.2d 593 (Del. Ch. 2006)).

For example, the Delaware Court of the Chancery has noted that the fiduciary duty of loyalty imposes an affirmative obligation to protect and advance the interests of the corporation and that a fiduciary may not engage in conduct that is adverse to the interests of the corporation. (*Shocking Technologies, Inc. v. Michael*, 2010 WL 4482838 (Del. Ch. 2012)). Though this Delaware case concerns fiduciaries of a corporation rather than a retirement system, the facts of the case are fairly analogous. A single fiduciary acted on his own to interfere with the actions of the Board and the interests of the corporation. Thus, the issue before the Delaware Court was whether a fiduciary could violate his fiduciary duty of loyalty by subverting the decisions of the board as a whole, even though acting in good faith.

The Delaware Court ultimately held that, while an aspect of good faith is encompassed in the duty of loyalty, it would be difficult to reconcile disloyal conduct with its likely "foreseeable (and intended)" consequences of causing serious harm to the corporation with the fiduciary duty of loyalty. That is, fiduciaries can unintentionally violate the duty of loyalty even while claiming to act in subjective good faith.

Consequently, it could be that even when the Treasurer is acting with good intentions, pursuant to the Treasurer's perceived fiduciary duties in one role, the Treasurer could unintentionally violate fiduciary monitoring or oversight duties to beneficiaries in one of his other fiduciary roles. It seems that the increased risks of fiduciary liability that result from the Treasurer being placed in multiple fiduciary roles with potentially conflicting obligations merit further consideration by policymakers.

## Appendix A: PEBA Fiduciary and Governance Legal Issues

The common law duty of prudence requires a trustee to exercise reasonable care, which, in turn, includes a duty to respond to apparent breaches by fellow trustees. (See *e.g.*, Restatement Third of Trusts § 77). Failure to respond to wrongdoing by fellow trustees can, in some instances, lead to co-fiduciary liability. (See *generally*, Restatement Third of Trusts § 81). Consequently, the PEBA cannot turn a blind eye to evident misconduct by the Treasurer or its other co-fiduciaries, whether or not the breach is intentional. However, this does not contemplate proactive monitoring or interference with duties that have been assigned by legislation to another fiduciary or co-trustee.<sup>8</sup> It is sometimes described as an obligation to take an "eyes open but nose out" approach to potential misconduct or breach by co-fiduciaries. The complex web of multiple co-fiduciaries with unclear overlapping duties established under South Carolina law makes this a particularly daunting task.

### III. Fiduciary Ambiguities Affecting PEBA

#### **Number of Fiduciaries Blurs Authority and Accountability**

The South Carolina Retirement System has four separate named fiduciaries with overlapping authority. The sources of these overlapping authorities are the following statutory provisions.

#### ***Budget and Control Board ("BCB")<sup>9</sup>***

- Named Trustee (S.C. Code Ann. § 9-1-1310)
- Fiduciary status as Trustee

#### ***Treasurer***

- Custodian of the funds (S.C. Code Ann. § 9-1-1320)
- "Other fiduciary" in role as custodian (S.C. AG Op. November 16, 2011)
- However, the custodian has a ministerial role only, with no investment authority (S.C. AG Op. November 16, 2011)
- Commissioner on RSIC (S.C. Code Ann. § 9-16-315)
- Member of BCB (S.C. Code Ann. § 1-11-10)

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<sup>8</sup> This is distinct from the situation where a fiduciary delegates fiduciary responsibility to another party, when it has a proactive obligation to exercise prudence in selecting, instructing and monitoring the party. *Restatement of Trusts, Third*, §§ 77 and 81.

<sup>9</sup> Effective July 2015, the Department of Administration or State Fiscal Accountability Authority.

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### ***Retirement System Investment Commission (RSIC)***

- Vested with exclusive investment authority (S.C. Code Ann. § 9-16-20)

### ***Public Employee Benefit Authority (PEBA)***

- Named Trustee (S.C. Code Ann. § 9-1-1310)
- Executive Director is non-voting Commissioner on RSIC (S.C. Code Ann. § 9-16-315)
- Directed by statute to (1) manage health plans and benefits and (2) approve a plan of benefits, eligibility and contributions for the health plans (S. C. Code Ann. § 1-11-710)

These authority and responsibility mismatches, as well as the overlaps and ambiguity around duties statutorily allocated amongst the Retirement System's fiduciaries, create the potential for conflicts and uncertainty as to which fiduciary has what authority and responsibility under what circumstances. The overlaps transcend personalities of current incumbents and present inherent issues in regard to who has accountability for shared responsibilities.

As was described in the Fiduciary Audit of the RSIC, the potential for conflicts is demonstrated most acutely by the multiple statutory roles assigned to the South Carolina State Treasurer and the impact of that overlap on the RSIC. However, this overlap also has consequence for the PEBA. Specifically, (1) that the Treasurer is a member of the BCB, which is a co-trustee with PEBA over the Retirement System; (2) that the BCB retains some oversight authority over the PEBA; and (3) overlapping responsibilities of the PEBA and the RSIC could impact how the PEBA is able to satisfy its fiduciary obligations.

### **Relationship between Treasurer, Budget Control Board and PEBA**

One of the Treasurer's fiduciary roles for the retirement system is as a member of the BCB. As further discussed below, the BCB appears to hold legal title to the retirement system's funds and appears to have both statutory and common law fiduciary responsibilities as a Trustee. For example, under common law trust principles, trustees are obligated to administer the trust in good faith, with prudence, and in accordance with their other fiduciary duties. (*See e.g.*, Restatement Third of Trusts § 70). The duty of prudence requires a trustee to exercise reasonable care, which, in turn, includes a duty to monitor the trust and fellow trustees. (*See e.g.*, Restatement Third of Trusts § 77). Failure to monitor the trust and fellow trustees can, in some instances, lead to co-fiduciary liability. (See above discussion and Restatement Third of Trusts § 81). Consequently, as a member of the BCB, the common law of trusts appears to give

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the Treasurer and BCB some degree of ambiguous oversight responsibility for the retirement system, which could expose the Treasurer and/or BCB to liability.

Adding to the potential for conflict is the confusion surrounding the role of BCB (whose powers are soon to be transferred to the Department of Administration and State Fiscal Accountability Authority) as co-trustee. The BCB, or its successor, is statutorily designated as a co-trustee of the retirement system. (S.C. Code Ann. § 9-1-1310 now provides, "The South Carolina Public Employee Benefit Authority and the State Budget and Control Board, or its successor, are co-trustees of the retirement system . . . in performing the functions imposed on them by law in the governance of the Retirement System.").

The BCB, however, has very limited statutorily-identified duties for the Retirement System.<sup>10</sup> Rather, nearly all duties were divided between the RSIC and the PEBA when they were created. ( S.C. Code § 9-16-315 (G) says, "All of the powers and duties of the State Budget and Control Board as investor in equity securities and the State Treasurer's function of investing in fixed income instruments are transferred to and devolved upon the Retirement System Investment Commission." Furthermore, S.C. Code Ann. § 9-4-10(H) provides that, "Effective July 1, 2012, the following offices, divisions, or components of the State Budget and Control Board are transferred to, and incorporated into, an administrative agency of state government to be known as the South Carolina Public Employee Benefit Authority: (1) Employee Insurance Program; and (2) the Retirement Division." )

Nevertheless, case law suggests that the BCB, as a named trustee, holds legal title to retirement fund assets. *See Hamiter v. Retirement System of the South Carolina Budget & Control Board*, 484 SE.2d 586 (S.C. 1997). While *Hamiter* was decided prior to the formation of the PEBA, the case may still be good law, as the court held that the BCB holds legal title to the assets because the BCB was statutorily designated as a trustee, which designation still remains. This further confuses the extent of authority and responsibility held by the BCB as a co-trustee.

### ***Transfer of BCB Functions***

Recent South Carolina legislation (Act 121) eliminates the BCB effective July 2015 and transfers its Retirement System oversight functions to the Department of Administration or State Fiscal Accountability Authority (SFAA). However, the statute designating BCB as co-trustee (S.C. Code

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<sup>10</sup> Other than being named a co-trustee of the Retirement System, the BCB's only other statutory duty is approval authority over all PEBA policy determinations (discussed below). *See* S. C. Code Ann. § 9-4-45.

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Ann. § 9-1-1310) was not amended as part of this bill.<sup>11</sup> Sections 2A and 18A of Act 121 contain ambiguous language on allocation of BCB powers to the Department of Administration and State Fiscal Accountability Authority. While history of the Act indicates that the General Assembly's intent was to transfer PEBA responsibilities to the SFAA, if the overlapping co-trustee structure is maintained, we recommend that future legislation replace references to the BCB in §§ 9-1-1310 and 9-4-45 with references to the SFAA in order to provide greater clarity that the SFAA is co-trustee of the Retirement System and the holder of PEBA policy approval powers.

### **Relationship between PEBA and BCB**

In addition to retaining a designation as trustee, it appears as though the BCB also retains approval authority over all policy determinations of the PEBA. (S.C. Code Ann. § 9-4-45 says, "(A) Policy determinations made by the South Carolina Public Benefit Authority are subject to approval by the State Budget and Control Board or its successor, evidenced by a majority vote of the board. (B) For purposes of this section, policy determination means a determination by law required to be made by the South Carolina Public Benefit Authority in its administration of the Employee Insurance Program relating to coverage changes and premium increases and in its administration of the Retirement Division, actuarial assumptions governing the retirement system and adjustments in employer and employee contributions.") The statute refers to policy determinations of the "Public Benefit Authority" rather than the PEBA, but it seems that these are the same entity.

For example, the statute specifically references policy determinations with regard to the Employee Insurance Program and the Retirement Division, which are the two divisions specifically transferred from the BCB to the PEBA. Consequently, it appears that the BCB retains some statutory authority related to the Retirement Systems and the RSIC in that the BCB must approve any PEBA policy determination with regard to coverage changes and premium increases, which could impact how effectively PEBA can manage the Employee Insurance Program.

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<sup>11</sup> Section 2.A of Act 121, on July 1, 2015, transfers all functions, powers, duties, responsibilities, and authority of the BCB related to executive functions, except as otherwise provided by law, to the Department of Administration. However, Section 18.A of the Act (which establishes the State Fiscal Accountability Authority) also gives the SFAA authority to decide any matters that would have previously been referred to the BCB for decision, where the procedure for the decision is not specifically provided for by general law. While we were advised that legislative intent was to transfer BCB Retirement System functions to the SFAA, these two Act Sections could be read as ambiguous and become the source of future conflict regarding the exercise of Retirement System oversight functions.

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### **Relationship between PEBA and RSIC**

A final level of ambiguity exists in the allocation of retirement system management and administration responsibilities between the PEBA and the RSIC. For example, the RSIC and the PEBA have agreed to assign responsibility for the accounting and audit functions of the Retirement System to the PEBA. (See Article II of the Memorandum of Understanding dated January 15, 2014.) However, it is not clear that PEBA has been statutorily granted this authority, as the RSIC has exclusive authority over the investment management of the Retirement System assets. (See S.C. Code Ann. § 9-16-20.) On the other hand, accounting and audit functions may be more akin to administration of the Retirement System, which is the statutory responsibility of the PEBA under S.C. Code Ann. § 9-4-30.

Either way, RSIC and PEBA have worked out a resolution of this ambiguity through the Memorandum of Understanding. If PEBA does not have clear statutory responsibility for accounting and audit functions, RSIC does have the ability to delegate this responsibility to PEBA under RSIC's delegation authority in S.C. Code Ann. § 9-16-30. Nevertheless, this illustrates another level of ambiguity in assignment of fiduciary authority and responsibility amongst the various entities with fiduciary duties. If personalities and agendas were to change at the two agencies, this ambiguity in assignment of authority and responsibility could also generate conflicts.

### **IV. Trust Assets are not State Funds**

The funds and assets of the Retirement Systems are statutorily designated as "not funds of the State," and are required to be held in trust for the intended beneficiaries. S. C. Stat. Ann. § 9-1-1310(C). The funds and assets of the South Carolina Retiree Health Insurance Trust fund and the South Carolina Long Term Disability Insurance Trust fund are also statutorily required to be held in trust for the benefit of employees and retirees and are distinct from the general funds of the State. S. C. Stat. Ann. §§ 1-11-705(A), 1-11-707(A). Additionally, the funds and assets received for health and dental insurance premiums, which are set aside in a separate account in the State Treasury under S. C. Stat. Ann. § 1-11-710(A)(4), appear to be covered by similar legal duties and may be construed as being held in an informal trust. (See below discussion.)

Use of the funds and assets of these trust funds (and the separate insurance account in the Treasury) is limited to the exclusive benefit of the participants and beneficiaries of the system to provide the benefits identified by statute. See e.g., S.C. Stat. Ann. § 9-1-20 ("A retirement

## Appendix A: PEBA Fiduciary and Governance Legal Issues

system is hereby established and placed under the management of the board for the purpose of providing retirement allowances and other benefits for teachers and employees of the State and political subdivisions or agencies or departments thereof.") S.C. Stat. Ann. § 1-11-710(A)(4) ("Funds credited to these accounts may be used to pay the costs of administering the state health and dental plans and may not be used for purposes of other than providing insurance benefits for employees and retirees.") S.C. Stat. Ann. § 1-11-710(A)(1) (PEBA "board shall make available to active and retired employees of this State and its public school districts and their eligible dependents group health, dental, life, accidental death and dismemberment, and disability insurance plans and benefits in an equitable manner and of maximum benefit to those covered within the available resources.") As discussed below, Trustees appear to owe similar legal duties to the participants and beneficiaries of all the insurance benefit programs..

Accordingly, as trustees of the retirement and benefit plans, PEBA members' legal duties run primarily to the participants and beneficiaries of those plans and not to any third parties. That being said, third parties who are stakeholders in the plans (*e.g.*, taxpayers, appointing authorities, employers, vendors, or other interested parties) can influence the success or viability of the plans and their interests can be taken into account. PEBA members' actions simply cannot be motivated by service to those third party stakeholders in derogation of their primary fiduciary obligations to plan participants and beneficiaries.

### V. Legal Standards Applicable to PEBA Management of Insurance Funds

The PEBA Board's duties owed to participants and beneficiaries of the insurance plans do not arise from the same statutory provision as for the retirement system. South Carolina statute section 9-16-40, "Standards for discharge of duty," applies only "*with respect to a retirement system.*" (Emphasis added.) Consequently, the fiduciary standard in section 9-16-40 does not apply to PEBA with respect to the insurance programs.

Nevertheless, funds of the retiree health insurance and the disability insurance funds are held in trust and the PEBA Board is statutorily designated as trustee for those funds under S.C. Code Ann. §§ 1-11-705 and .1-11-707. In addition, although funds of other employee insurance plans are not explicitly placed into trust funds,<sup>12</sup> a similar standard of loyalty as is used for the Retirement System applies to the PEBA Board in administering all insurance funds. S.C. Code

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<sup>12</sup> Under S.C. Code Ann § 1-11-710(A)(4) all funds received for employee health and dental insurance premiums are set aside in a separate account in the Treasury rather than being placed in a trust.

## Appendix A: PEBA Fiduciary and Governance Legal Issues

Ann. § 1-11-710 explicitly requires the PEBA Board to administer group health, dental, life, accidental death and dismemberment, and disability insurance plans and benefits for active and retired employees "*in an equitable manner and of maximum benefit to those covered within the available resources.*" (Emphasis added.) In addition, S. C. Stat. Ann. § 1-11-710(A)(4) limits funds received for health and dental insurance premiums to being used only for providing insurance benefits to employees and retirees, not for any other purpose.

These provisions seem to apply the substantial equivalent of the Retirement System's "exclusive benefit" fiduciary loyalty standard. Consequently, PEBA board members are either designated trustees or are subject to loyalty and impartiality standards in administering the insurance plans similar to those applied to the Retirement System.

Furthermore, even the insurance funds not being placed in a formal trust are used to provide insurance benefits and could be found to be held in an informal trust. Informal trusts can be created without an express statement that the arrangement is intended to be a trust. See Restatement Third of Trusts § 91, comment h. The Restatement Third of Trusts provides the following example of an informal trust: a person gives a second person a check or specific asset with some understanding that the latter is to hold and manage the property as a trustee for the benefit of the transferor or one or more others. *Id.*

Because the PEBA collects various contributions from employers and employees, most of which are placed into trust funds for purposes of providing retirement and insurance benefits, it is likely that those employers and employees would reasonably expect that all funds collected for employee insurance benefits are similarly held in trust for the benefit of the employees. Accordingly, PEBA board members may be considered trustees even without a formal trust and be subject to common law fiduciary principles.

As a potential de facto trustee for these insurance programs, it appears likely a court would find that PEBA is subject to the same fiduciary principles discussed above for all retirement and insurance benefit funds. Because most of the same insurance program employers and employees also participate in retirement system, they could reasonably expect that the same fiduciary standards would apply if an informal trust relationship were found to exist.

Nevertheless, there is some ambiguity as to applicability of trust fund status and fiduciary standards for management of funds that are not explicitly held in statutory trust funds, such as monies for the Employee Health and Dental Insurance Programs. While we do not believe that a statutory fix is required, to provide greater clarity, PEBA could seek legislative action explicitly placing all insurance benefit funds into an employee benefits trust. PEBA could be statutorily

## **Appendix A: PEBA Fiduciary and Governance Legal Issues**

designated as trustee of these insurance plan assets, and the fiduciary standard applicable to the retirement system could be specifically expanded to apply to them.

## Appendix A: PEBA Fiduciary and Governance Legal Issues

### From RSIC Report - Potential Options for Realignment of the Duties of the State Treasurer

| Option                                                                                                 | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Status Quo:</b><br><b>Custodian: Treasurer</b><br><b>Relationship: Treasurer</b>                    | <ul style="list-style-type: none"> <li>• No significant changes</li> <li>• The Treasurer remains the custodian</li> <li>• STO implements its new Custody Officer role</li> <li>• RSIC proceeds to implement its investment administrator role</li> <li>• This structure is unique to South Carolina among U.S. state investment boards with an independent investment staff</li> </ul>                                                                                                                                                                                                                                                                 |
| <b>Option 1: Improved Status Quo</b><br><b>Custodian: Treasurer</b><br><b>Relationship: RSIC</b>       | <ul style="list-style-type: none"> <li>• The Treasurer remains the custodian</li> <li>• The Treasurer delegates authority to RSIC to conduct custodial bank selection, negotiate the contract, and manage the contract and relationship for the retirement funds</li> <li>• Authorization processes are streamlined to not require STO signatures and utilize electronic payment authorization</li> <li>• Service level agreement and performance feedback are implemented by RSIC</li> <li>• The internal accounting system is updated (not related to custodian)</li> <li>• Similar to Washington State Investment Board (WSIB) structure</li> </ul> |
| <b>Option 2: RSIC Custody Relationship</b><br><b>Custodian: Treasurer</b><br><b>Relationship: RSIC</b> | <ul style="list-style-type: none"> <li>• The Treasurer retains the title of Custodian</li> <li>• Legislative change provides for delegation of authority to RSIC to conduct custodial bank selection, negotiate the contract, and manage the contract and relationship for the retirement funds</li> <li>• Similar to the Illinois State Board of Investments (ISBI) and New Mexico ERB structure</li> </ul>                                                                                                                                                                                                                                           |
| <b>Option 3: PEBA as Custodian</b><br><b>Custodian: PEBA</b><br><b>Relationship: RSIC</b>              | <ul style="list-style-type: none"> <li>• Legislative change provides for: <ul style="list-style-type: none"> <li>– PEBA to become the custodian of record</li> <li>– RSIC to contract with its own custodial bank and manage the custodial bank relationship for the retirement funds</li> </ul> </li> <li>• Similar to the Minnesota State Board of Investments (SBI) structure</li> </ul>                                                                                                                                                                                                                                                            |
| <b>Option 4: RSIC as Custodian</b><br><b>Custodian: RSIC</b><br><b>Relationship: RSIC</b>              | <ul style="list-style-type: none"> <li>• Legislative change provides for RSIC to become the custodian of record and to contract with its own custodial bank and manage the custodial bank relationship for the retirement funds</li> <li>• Similar to Florida SBA, Massachusetts PRIM, West Virginia IMB, and SWIB structure</li> </ul>                                                                                                                                                                                                                                                                                                                |

## **Appendix B: 2013 CEM Benchmarking Report Executive Summary**

### **Defined Benefit Administration Benchmarking Analysis** Fiscal Year 2013

### **South Carolina Retirement Systems** (Administered by SC Public Employee Benefit Authority)

Final Report - 12 March, 2014

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## Appendix B: 2013 CEM Benchmarking Report Executive Summary

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### How to use this report

- To improve service levels
  - Compare your service levels to your peers
  - Insight into best practices
- To manage costs
  - Understand the factors that influence costs
  - Support arguments for investments in people or infrastructure
- To support business decisions
  - Understand how and where other funds are investing in people, technology, service and growth
- To develop performance goals and standards
  - Develop your performance framework and set realistic goals
  - Measure the impact of major operations changes
- To measure and manage your performance
  - Monitor your annual progress using an outside benchmark
- To communicate to stakeholders
  - Demonstrate success and achievements to governing bodies
  - Show progress to employees to recognize success and motivate

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

75 leading global pension systems participate in the benchmarking service.

| Participants                |                                             |                      |                                          |
|-----------------------------|---------------------------------------------|----------------------|------------------------------------------|
| <u>Canada</u>               | <u>The Netherlands</u>                      | <u>United States</u> |                                          |
| APS                         | ABP                                         | Arizona SRS          | South Carolina PEBA                      |
| BC Pension Corporation      | bpfBOUW                                     | CalPERS              | South Dakota RS                          |
| Defence Canada              | BPF Schilders                               | CalSTRS              | STRS Ohio                                |
| Federal Public Service      | Pensioenfond Metaal en Techniek             | Colorado PERA        | SURS Illinois                            |
| HOOPP                       | Pensioenfond van de Metalektro              | Delaware PERS        | Texas MRS                                |
| LAPP                        | PFZW                                        | Florida RS           | TRS Louisiana                            |
| OMERS                       | Rabobank Pensioenfond                       | Idaho PERS           | TRS of Texas                             |
| Ontario Pension Board       | Stichting Pensioenfond Medisch Specialisten | Illinois MRF         | Utah RS                                  |
| Ontario Teachers            |                                             | Indiana PRS          | Virginia RS                              |
| OPTrust                     |                                             | Iowa PERS            | Washington State DRS                     |
| RCMP                        | <u>Australia*</u>                           | KPERS                | Wisconsin DETF                           |
| Saskatchewan HEPP           | AustralianSuper                             | LACERA               |                                          |
|                             | BUSS(Q)                                     | Michigan ORS         | <u>United Kingdom*</u>                   |
| <u>Scandinavia</u>          | CBUS                                        | MOSERS               | Armed Forces Pension Schemes             |
| Alecta                      | First State Super                           | Nevada PERS          | BMW                                      |
| ATP                         | HESTA                                       | New Mexico ERB       | BSA NHS Pension Scheme                   |
|                             | QSuper                                      | NYC TRS              | Principal Civil Service Pension Scheme   |
| <u>United Arab Emirates</u> | REST                                        | NYSLRS               | Railway Pensions Scheme                  |
| Abu Dhabi RPB               | StatewideSuper                              | Ohio PERS            | Scottish Public Pension Agency (SPPA)    |
|                             | SunSuper                                    | Orange County ERS    | The Pension Protection Fund (PPF)        |
|                             | VicSuper                                    | Oregon PERS          | Unilever                                 |
|                             |                                             | Pennsylvania PSERS   | Universities Superannuation Scheme (USS) |

\* Systems from Australia and the UK complete separate benchmarking surveys and hence your analysis does not include their results

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

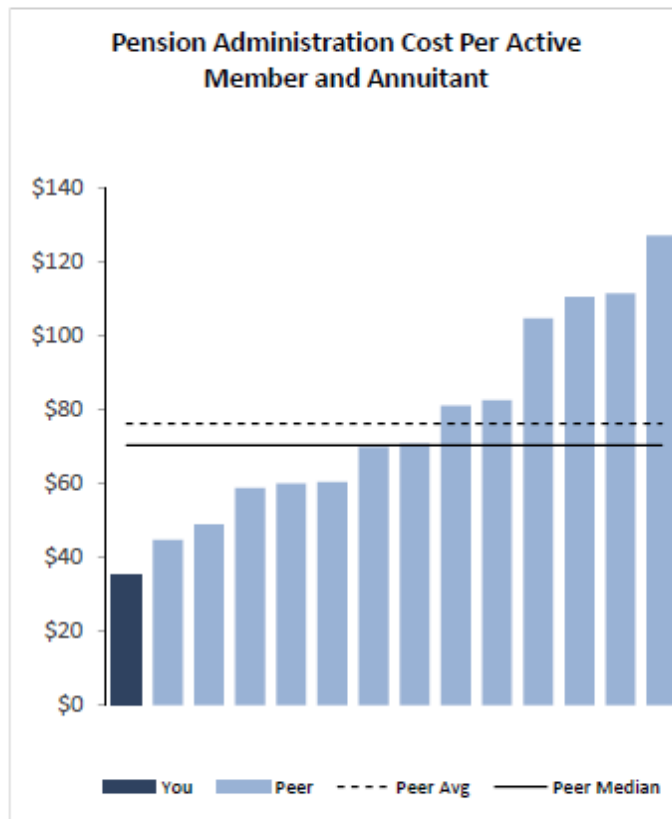
The custom peer group for South Carolina Retirement Systems consists of the following 14 peers:

| Custom Peer Group for South Carolina Retirement Systems |                              |            |       |
|---------------------------------------------------------|------------------------------|------------|-------|
| Peers (sorted by size)                                  | <u>Membership (in 000's)</u> |            |       |
|                                                         | Active Members               | Annuitants | Total |
| Ohio PERS                                               | 348                          | 191        | 539   |
| Virginia RS                                             | 341                          | 170        | 510   |
| Michigan ORS                                            | 243                          | 256        | 500   |
| Pennsylvania PSERS                                      | 284                          | 208        | 492   |
| Washington State DRS                                    | 291                          | 151        | 442   |
| Wisconsin DETF                                          | 257                          | 174        | 430   |
| <b>South Carolina Retirement</b>                        | 257                          | 148        | 406   |
| Indiana PRS                                             | 253                          | 133        | 386   |
| STRS Ohio                                               | 198                          | 149        | 348   |
| Colorado PERA                                           | 230                          | 100        | 330   |
| Arizona SRS                                             | 203                          | 125        | 328   |
| Oregon PERS                                             | 167                          | 126        | 293   |
| Illinois MRF                                            | 175                          | 102        | 277   |
| Iowa PERS                                               | 165                          | 105        | 270   |
| Peer Median                                             | 248                          | 149        | 396   |
| Peer Average                                            | 244                          | 153        | 396   |

Inactive members are not considered when selecting peers because they are excluded when determining cost per member. They are excluded because they are less costly to administer than either active members or annuitants.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

Your total pension administration cost was \$35 per active member and annuitant. This was \$41 below the peer average of \$76 and the lowest cost among your peers.



Your total pension administration cost was \$14.4 million. This excludes the fully-attributed cost of administering healthcare, and optional and third-party administered benefits of \$0.3 million.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

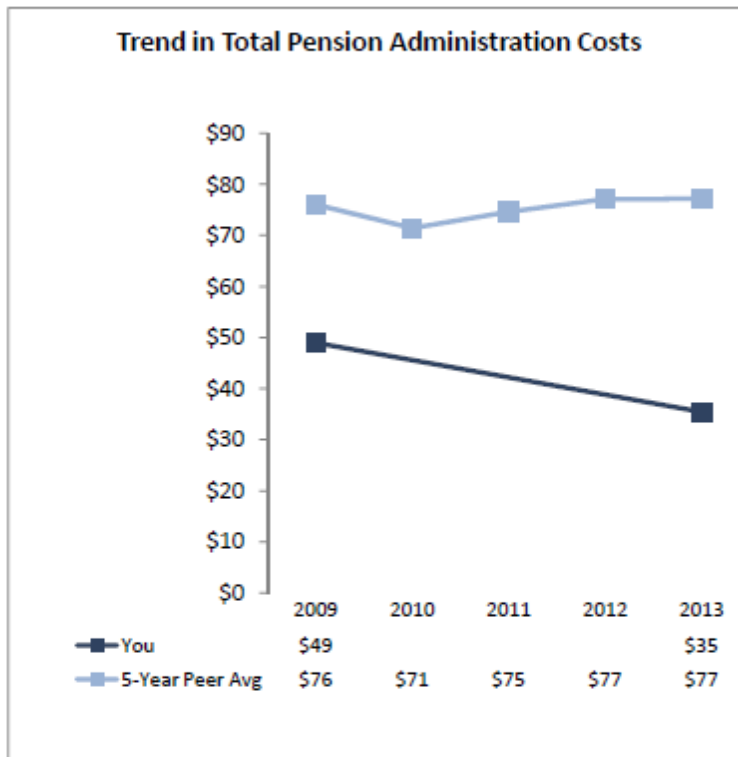
### Cost comparison per activity.

| Activity                                                      | (\$000s)      | \$s per Active Member and Annuitant |              |              | More/ -Less (vs. average) |             |
|---------------------------------------------------------------|---------------|-------------------------------------|--------------|--------------|---------------------------|-------------|
|                                                               | You           | You                                 | Peer Med     | Peer Avg     | \$s                       | %           |
| <b>1. Member Transactions</b>                                 |               |                                     |              |              |                           |             |
| a. Pension Payments                                           | 457           | 1.13                                | 2.79         | 2.73         | -1.61                     | -59%        |
| b. Pension Inceptions                                         | 927           | 2.28                                | 2.44         | 3.65         | -1.37                     | -38%        |
| c. Withdrawals and Transfers-out                              | 603           | 1.49                                | 0.91         | 1.32         | 0.17                      | 13%         |
| d. Purchases and Transfers-in                                 | 601           | 1.48                                | 1.09         | 1.15         | 0.33                      | 29%         |
| e. Disability                                                 | 589           | 1.45                                | 1.59         | 2.52         | -1.07                     | -42%        |
| <b>2. Member Communication</b>                                |               |                                     |              |              |                           |             |
| a. Call Center                                                | 1,273         | 3.14                                | 4.64         | 4.95         | -1.81                     | -37%        |
| b. Mail Room, Imaging                                         | 497           | 1.22                                | 1.83         | 2.19         | -0.97                     | -44%        |
| c. 1-on-1 Counseling                                          | 641           | 1.58                                | 1.66         | 1.97         | -0.39                     | -20%        |
| d. Presentations and Group Counseling                         | 136           | 0.33                                | 1.05         | 1.25         | -0.92                     | -73%        |
| e. Written Pension Estimates                                  | 95            | 0.23                                | 0.86         | 1.06         | -0.83                     | -78%        |
| f. Mass Communication                                         | 614           | 1.51                                | 2.71         | 3.18         | -1.67                     | -52%        |
| <b>3. Collections and Data Maintenance</b>                    |               |                                     |              |              |                           |             |
| a. Data and Money from Employers                              | 696           | 1.72                                | 1.97         | 2.62         | -0.90                     | -35%        |
| b. Service to Employers                                       | 367           | 0.90                                | 1.19         | 1.54         | -0.63                     | -41%        |
| c. Data Not from Employers                                    | 170           | 0.42                                | 0.99         | 1.03         | -0.61                     | -59%        |
| <b>4. Governance and Financial Control</b>                    |               |                                     |              |              |                           |             |
| a. Financial Administration and Control                       | 449           | 1.11                                | 2.11         | 2.20         | -1.10                     | -50%        |
| b. Board, Strategy, Policy                                    | 211           | 0.52                                | 1.64         | 1.72         | -1.20                     | -70%        |
| c. Government and Public Relations                            | 113           | 0.28                                | 0.60         | 0.92         | -0.64                     | -70%        |
| <b>5. Major Projects</b>                                      |               |                                     |              |              |                           |             |
| a. Amortization of non-IT Major Projects                      | 0             | 0.00                                | 0.00         | 0.01         | -0.01                     | -100%       |
| b. Non-IT Major Projects (if you don't capitalize)            | 0             | 0.00                                | 0.00         | 1.21         | -1.21                     | -100%       |
| c. Amortization of IT Major Projects                          | 0             | 0.00                                | 0.13         | 2.06         | -2.06                     | -100%       |
| d. IT Major Projects (if you don't capitalize)                | 0             | 0.00                                | 0.40         | 4.71         | -4.71                     | -100%       |
| <b>6. Information Technology</b>                              |               |                                     |              |              |                           |             |
| a. IT Strategy, Database, Applications (excl. major projects) | 2,048         | 5.05                                | 12.92        | 13.33        | -8.28                     | -62%        |
| b. IT Desktop, Networks, Telecom                              | 1,240         | 3.06                                | 4.90         | 5.16         | -2.11                     | -41%        |
| <b>7. Support Services and Other</b>                          |               |                                     |              |              |                           |             |
| a. Building and Utilities                                     | 868           | 2.14                                | 3.99         | 4.94         | -2.80                     | -57%        |
| b. Human Resources                                            | 238           | 0.59                                | 1.03         | 1.34         | -0.76                     | -56%        |
| c. Actuarial                                                  | 235           | 0.58                                | 1.32         | 1.50         | -0.92                     | -61%        |
| d. Legal and Rule Interpretation                              | 394           | 0.97                                | 1.85         | 2.55         | -1.58                     | -62%        |
| e. Internal and External Audit                                | 301           | 0.74                                | 1.08         | 1.20         | -0.46                     | -38%        |
| f. Other Support Services                                     | 241           | 0.59                                | 0.98         | 1.84         | -1.25                     | -68%        |
| <b>Total Pension Administration</b>                           | <b>14,388</b> | <b>35.46</b>                        | <b>70.32</b> | <b>76.13</b> | <b>-40.67</b>             | <b>-53%</b> |

Your total cost of \$14.4 million excludes the fully-attributed cost of administering optional third party administered benefits of \$0.3 million. Your direct costs per the survey for activities 4, 6 and 7 been reduced by attributions to the excluded activity that add up to \$0.1 million. Refer to section 3, page 21 for details.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Cost Trends

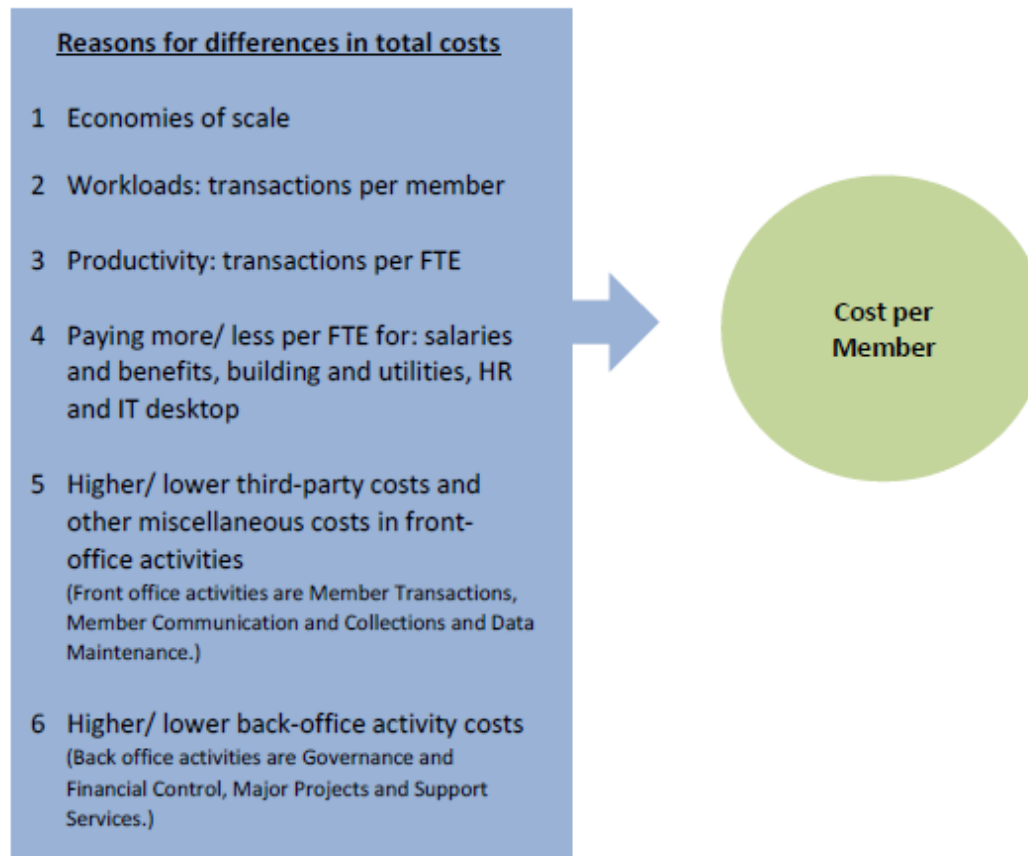


Your total pension administration cost per active member and annuitant decreased by 7.7% per annum between 2009 and 2013. During this same period, the average cost of your peers with 5 years of consecutive data increased by 0.4% per annum.

Trend analysis is based on systems that have provided 5 consecutive years of data (11 of your 14 peers).

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

CEM uses the following cost model to explain differences in total costs:



## Appendix B: 2013 CEM Benchmarking Report Executive Summary

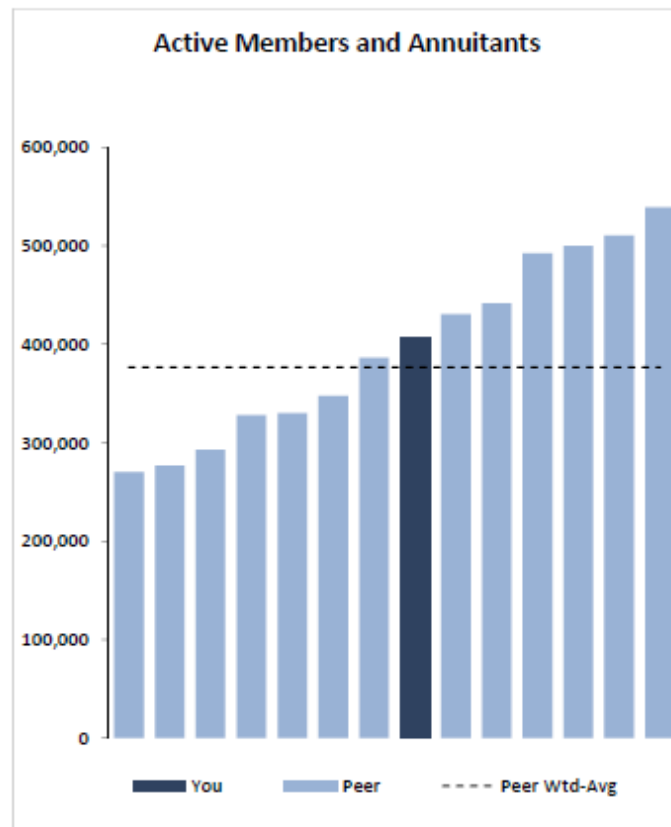
Reasons why your total cost was \$41 below the peer average.

| Reason                                                                                       | Impact   |
|----------------------------------------------------------------------------------------------|----------|
| 1. Economies of scale advantage                                                              | -\$0.81  |
| 2. Lower transactions per member (workloads)                                                 | -\$2.71  |
| 3. Slightly lower transactions per FTE (productivity)                                        | \$0.78   |
| 4. Lower costs per FTE for: salaries and benefits, building and utilities, HR and IT desktop | -\$14.16 |
| 5. Lower third-party and other costs in front-office activities                              | -\$5.35  |
| 6. Paying more/-less for back-office activities:                                             |          |
| - Governance and Financial Control                                                           | -\$1.83  |
| - Major Projects                                                                             | -\$7.32  |
| - IT Strategy, Database, Applications (excl. major projects)                                 | -\$5.79  |
| - Actuarial, Legal, Audit, Other Support Services                                            | -\$3.47  |
| Total                                                                                        | -\$40.67 |

CEM reconciles to the peer average instead of the peer median because there are interactions between the reasons that would be lost if we used medians. For example, high major project costs may be associated with high productivity. Also, the reasons will only add to 100% if we used averages.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Reason 1: You had an economies of scale advantage.



The peer-average is weighted with a higher weight to smaller plans because the relationship between size and cost is not linear.

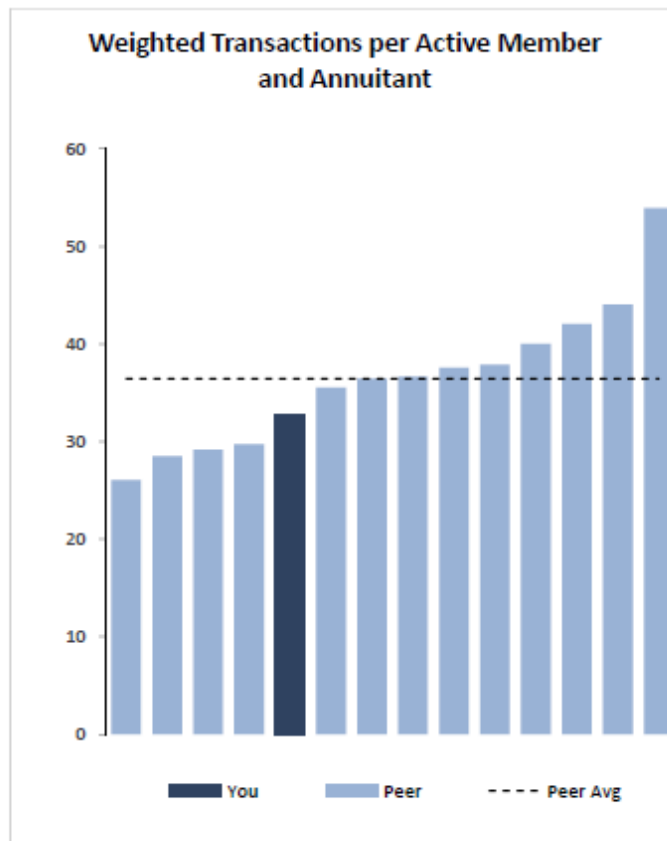
Your system had 8% more members than the peer weighted-average. Your larger size means that you had a cost advantage relative to the average peer of \$0.81 per member.

Size is a key driver of costs. More members lets you spread your fixed costs over a larger base. But the benefit of economies of scale is not linear. Scale economies diminish as systems get larger.

| How Changes in Membership Impact Your Cost |              |                           |                    |
|--------------------------------------------|--------------|---------------------------|--------------------|
| % Change in Members                        | # of Members | Predicted Cost per Member | Increase/-Decrease |
| -75%                                       | 101,449      | \$66.94                   | \$31.48            |
| -50%                                       | 202,897      | \$45.95                   | \$10.49            |
| -25%                                       | 304,346      | \$38.95                   | \$3.50             |
| 0%                                         | 405,794      | \$35.46                   | \$0.00             |
| +25%                                       | 507,243      | \$33.36                   | -\$2.10            |
| +50%                                       | 608,691      | \$31.96                   | -\$3.50            |
| +75%                                       | 710,140      | \$30.96                   | -\$4.50            |

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Reason 2: You had lower transaction volumes per member (workloads).



Your weighted transactions were 10% below the peer average. Your lower transaction volumes decreased your total cost per member by an estimated \$2.71 relative to the peer average.

Weighted transactions indicates whether you are doing more or fewer transactions per member in aggregate than your peers. The weights used were the median cost per transaction of all participants. This enables us to normalize for the substantial differences in time and effort expended on each type of task. For example, a 1-on-1 counseling session is more costly and time consuming than answering a telephone call.

The following page shows where you are doing more and/or fewer transactions by front-office activity.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Where did you do more/fewer transactions?

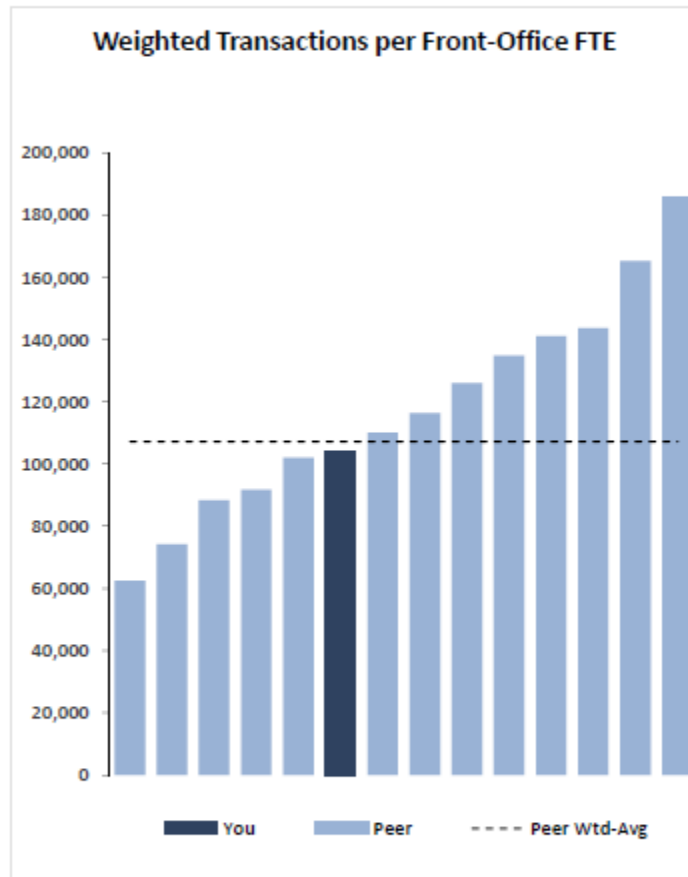
| Where did you do more/fewer transactions?                   |                                                |              |            |                                  |
|-------------------------------------------------------------|------------------------------------------------|--------------|------------|----------------------------------|
| Front Office Transactions (or Transaction Driver)           | Volume per 1,000 Active Members and Annuitants |              |            | \$ per Member Transaction Impact |
|                                                             | You                                            | Peer Average | More/-Less |                                  |
| 1. Member Transactions                                      |                                                |              |            |                                  |
| a. Pension Payments (Annuitants)                            | 366                                            | 384          | -5%        | -\$0.12                          |
| b. New Payee Inceptions                                     | 25                                             | 27           | -8%        | -\$0.26                          |
| c. Withdrawals and Transfers-out                            | 23                                             | 28           | -17%       | -\$0.21                          |
| d. Purchases and Transfers-in                               | 12                                             | 10           | 24%        | \$0.33                           |
| e. Disability Applications                                  | 2.5                                            | 2.3          | 11%        | \$0.19                           |
| 2. Member Communication                                     |                                                |              |            |                                  |
| a. Calls and Emails                                         | 414                                            | 661          | -37%       | -\$1.49                          |
| b. Incoming Mail                                            | 315                                            | 423          | -25%       | -\$0.41                          |
| c. Members Counseled 1-on-1                                 | 42                                             | 24           | 75%        | \$0.89                           |
| d. Member Presentations                                     | 0                                              | 1            | -68%       | -\$0.86                          |
| e. Written Estimates                                        | 12                                             | 28           | -58%       | -\$0.87                          |
| 3. Collections and Data Maintenance                         |                                                |              |            |                                  |
| a. Data and Money from Employers (Active Members)           | 634                                            | 616          | 3%         | \$0.08                           |
| b. Service to Employers (Active Members)                    | 634                                            | 616          | 3%         | \$0.04                           |
| c. Data Not from Employers (Actives, Inactives, Annuitants) | 1,425                                          | 1,455        | -2%        | -\$0.02                          |
| Weighted Total                                              | 32,725                                         | 36,444       | -10%       | -\$2.71                          |

Differences in transaction volumes per member reflect differences in:

- Membership mix (active, inactive, annuitant)
- Member demographics. For example, you may have a higher proportion of active members approaching retirement.
- Member type/ industry group.
- System and plan complexity. For example, if you administer healthcare, you will have higher communication needs.
- Service Levels

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Reason 3: You had slightly lower transactions per FTE (total productivity).



Your weighted transactions per front-office FTE were 3% below the peer weighted-average (adjusted for economies of scale to avoid double counting). Your lower transaction volumes per FTE increased your total cost per member by \$0.78 relative to the peer average.

Differences in transaction volumes per FTE are due to differences in:

- Economies of scale. CEM research shows that smaller systems had lower productivity than larger systems
- IT capability / on-line transactions
- Service levels
- Complexity of plan rules
- Staff skills and staff productivity
- Use of consultants versus internal staff
- Projects
- Organization design

It is important to emphasize that total productivity is not a measure of staff productivity; staff productivity is, however, a component of total productivity.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

**Reason 4: You had lower costs per FTE for: salaries and benefits, IT desktop, networks and telecom, building and utilities, and human resources.**

| Cost per FTE                  |          |           |                     |
|-------------------------------|----------|-----------|---------------------|
|                               | You      | Peer Avg  | FTE-Wtd<br>Peer Avg |
| Salaries and Benefits         | \$61,624 | \$82,440  | \$80,421            |
| Building and Utilities        | \$5,013  | \$9,425   | \$9,554             |
| Human Resources               | \$1,375  | \$2,492   | \$2,597             |
| IT Desktop, Networks, Telecom | \$7,160  | \$10,089  | \$9,987             |
| Total                         | \$75,171 | \$104,446 | \$102,558           |

Your lower costs per FTE decreased your total cost by \$14.16 per member relative to the peer average.

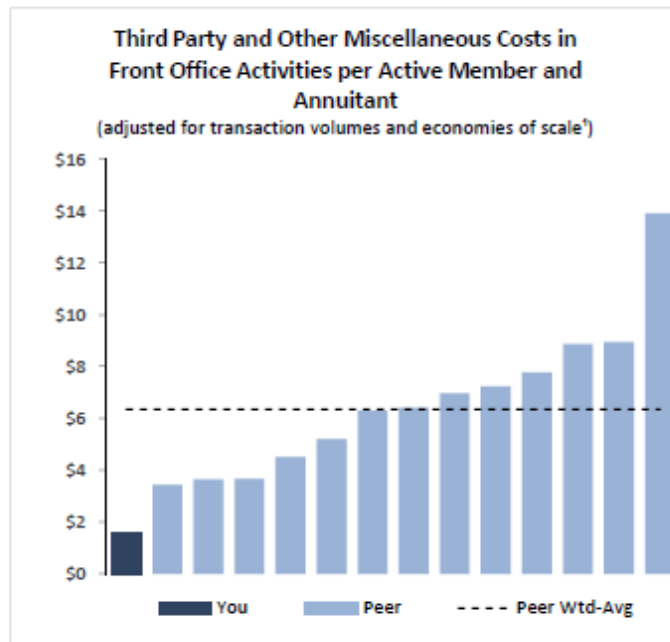
The peer average is weighted such that peers with more FTEs get a higher weight because 'cost per FTE' differences matter more for peers with more FTEs.

Differences in your cost per FTE reflect differences in:

- Organization structure, strategy and history.
- Outsourcing and use of consultants.
- Cost environment of your location vs. peers. Labor costs in your area were 10%

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Reason 5: You had lower third party and other miscellaneous costs in the front-office activities.



Your third party and other miscellaneous costs (such as travel, office supplies, etc.) in the front-office activities<sup>2</sup> were \$1.55 per member which was 76% below the adjusted peer weighted average of \$6.36. Your lower third party costs decreased your total cost per member by \$5.35 relative to the peer average.

1. To avoid double counting, peer costs are adjusted for differences in transaction volumes and economies of scale.
2. Front office activities are activities that come in contact with clients or employers, such as paying pensions, member calls and presentations. It excludes back-office activities such as Governance and Financial Control, Major Projects and Support Services.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Reason 6: You paid less for back-office activities.

| Back-Office Activities - Adjusted Cost per Member |         |          |                |
|---------------------------------------------------|---------|----------|----------------|
| Back Office Activities                            | You     | Peer Avg | More/<br>-less |
| Governance and Financial Control                  | \$2.57  | \$4.40   | -\$1.83        |
| Major Projects                                    | \$0.00  | \$7.32   | -\$7.32        |
| IT Strategy, Database, Applications               | \$5.85  | \$11.64  | -\$5.79        |
| Actuarial, Legal, Audit, Other                    | \$3.18  | \$6.65   | -\$3.47        |
| Total                                             | \$11.60 | \$30.02  | -\$18.42       |

To avoid double counting, back office costs are adjusted for economies of scale and cost per FTE for: salaries, benefits, building, utilities, IT desktop and human resources. Before adjustments, your total costs for the above back-office activities were \$20. The unadjusted peer average was \$50.

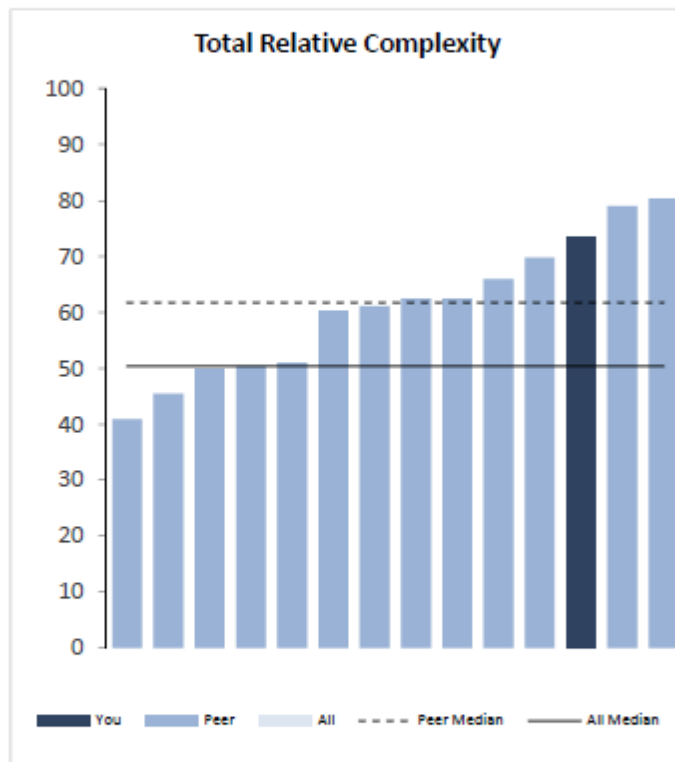
Your adjusted cost per active member and annuitant of \$11.60 for back-office activities was below the peer average of \$30.02. Paying less for back-office activities decreased your total cost per member by \$18.42 relative to the peer average.

Differences in cost per member for back-office activities reflects differences in:

- How much you do. For example, some systems invest more in disaster recovery.
- IT capability
- IT investment cycle
- Plan complexity

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

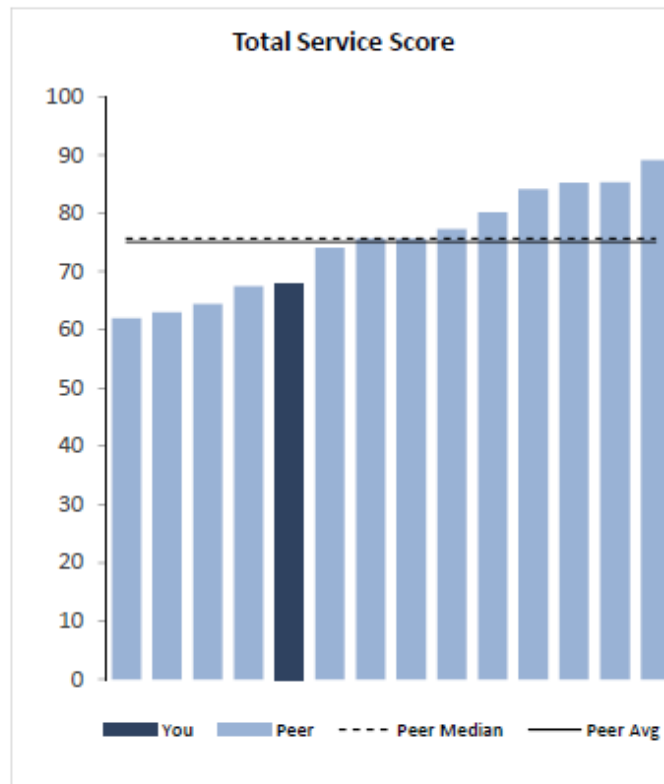
Back-office costs and productivity are impacted by system complexity. Your total relative complexity score of 73 was above the peer median of 62.



| Relative Complexity Score by Cause<br>(0 least - 100 most) |     |          |
|------------------------------------------------------------|-----|----------|
| Cause                                                      | You | Peer Avg |
| Pension Payment Options                                    | 71  | 55       |
| Customization Choices                                      | 3   | 5        |
| Multiple Plan Types and Overlay:                           | 63  | 52       |
| Multiple Benefit Formula                                   | 57  | 41       |
| External Reciprocity                                       | 0   | 29       |
| COLA Rules                                                 | 24  | 28       |
| Contribution Rates                                         | 78  | 53       |
| Variable Compensation                                      | 85  | 84       |
| Service Credit Rules                                       | 77  | 61       |
| Divorce Rules                                              | 55  | 67       |
| Purchase Rules                                             | 90  | 69       |
| Refund Rules                                               | 46  | 42       |
| Disability Rules                                           | 89  | 79       |
| Translation                                                | 0   | 6        |
| Defined Contribution Plan Rules                            | 100 | 71       |
| Total Relative Complexity                                  | 73  | 61       |

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

Your total service score was 68. This was below the peer median of 76.



Service is defined from a member's perspective. Higher service means faster turnaround times, more availability, more choice and higher quality. Examples of key service metrics are shown on the next page.

A higher service score is not necessarily better. This is because:

- High service may not always be cost effective or optimal. For example, it is higher service for your members to have a contact center open 24 hours a day. But few systems would be able to justify the cost.
- The weights CEM uses are an approximation of the importance of individual service elements. The weights will not always reflect the relative importance that you or your members attach to individual service elements.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

The total service score is the weighted average of the activity level service scores.

| Service Scores by Activity       |        |                  |             |                  |
|----------------------------------|--------|------------------|-------------|------------------|
| Activity                         | Weight | Score out of 100 |             |                  |
|                                  |        | You              | Peer Median | % Higher /-Lower |
| 1. Member Transactions           |        |                  |             |                  |
| a. Pension Payments              | 19.7%  | 98               | 97          | 1%               |
| b. Pension Inceptions            | 7.4%   | 89               | 85          | 5%               |
| c. Withdrawals and Transfers-out | 0.3%   | 90               | 88          | 2%               |
| d. Purchases and Transfers-in    | 3.1%   | 65               | 83          | -22%             |
| e. Disability                    | 4.8%   | 91               | 86          | 6%               |
| 2. Member Communication          |        |                  |             |                  |
| a. Call Center                   | 21.2%  | 49               | 53          | -8%              |
| c. 1-on-1 Counseling             | 7.4%   | 73               | 76          | -4%              |
| d. Member Presentations          | 6.5%   | 70               | 86          | -19%             |
| e. Written Pension Estimates     | 4.7%   | 71               | 86          | -17%             |
| f. Mass Communication            |        |                  |             |                  |
| a. Website                       | 7.6%   | 70               | 78          | -10%             |
| b. Newsletters                   | 3.8%   | 0                | 88          | -100%            |
| c. Member statements             | 6.6%   | 46               | 80          | -43%             |
| d. Other mass communication      | 0.9%   | 10               | 51          | -80%             |
| 3. Other                         |        |                  |             |                  |
| Satisfaction Surveying           | 5.0%   | 52               | 43          | 21%              |
| Disaster Recovery                | 1.0%   | 55               | 87          | -37%             |
| Weighted Total Service Score     | 100.0% | 68               | 76          | -11%             |

Employer service is excluded from your total service score. Please refer to Appendix D for methodology changes.

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Examples of key service measures included in your Service Score:

| Select Key Service Metrics                                                                                                                                            | You      | Peer Avg |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| <u>Member Contacts</u>                                                                                                                                                |          |          |
| • % of calls resulting in undesired outcomes (busy signals, messages, hang-ups)                                                                                       | 14%      | 14%      |
| • Average total wait time including time negotiating auto attendants, etc.                                                                                            | 163 secs | 177 secs |
| <u>Website</u>                                                                                                                                                        |          |          |
| • Can members access their own data in a secure environment?                                                                                                          | Yes      | 93% Yes  |
| • Do you have an online calculator linked to member data?                                                                                                             | No       | 86% Yes  |
| • # of other website tools offered such as changing address information, registering for counseling sessions and/or workshops, viewing or printing tax receipts, etc. | 10       | 8        |
| <u>1-on-1 Counseling and Member Presentations</u>                                                                                                                     |          |          |
| • % of your active membership that attended a 1-on-1 counseling session                                                                                               | 6.6%     | 3.9%     |
| • % of your active membership that attended a presentation                                                                                                            | 3.4%     | 5.5%     |
| <u>Pension Inceptions</u>                                                                                                                                             |          |          |
| • What % of annuity pension inceptions are paid without an interruption of cash flow greater than 1 month between the final pay check and the first pension check?    | 99.3%    | 89.2%    |
| • What % of annuity pension inceptions were initiated online?                                                                                                         | n/a      | 35%      |
| <u>Member Statements</u>                                                                                                                                              |          |          |
| • How current is an active member's data in the statements that the member receives?                                                                                  | 3.0 mos  | 2.4 mos  |
| • Do statements provide an estimate of the future pension entitlement?                                                                                                | No       | 57% Yes  |

## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Biggest potential improvements to your total service score

| Biggest potential improvements to your total service score |                                                                                                                                                                                                                                     |                       |
|------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|
| Rank                                                       | Factor                                                                                                                                                                                                                              | Potential Improvement |
| # 1                                                        | On average, members calling your call center reach a knowledgeable person in 163 seconds. To achieve a perfect service score, members must reach a knowledgeable person on the phone in 20 seconds or less.                         | + 4.1                 |
| # 2                                                        | 13.6% of your incoming calls resulted in undesired outcomes, and 0.0% of your incoming calls resulted in irritating outcomes. To achieve a perfect service score, members must experience no undesired or irritating call outcomes. | + 3.2                 |
| # 3                                                        | Your member statements do not show members an estimate of future pension entitlements. To achieve a perfect service score member statements must show members an estimate of future pension entitlements.                           | + 1.7                 |
| # 4                                                        | You send newsletters to active members 0 times per year. To achieve a perfect service score you must send newsletters to active members 2 or more times per year.                                                                   | + 1.3                 |
| # 5                                                        | You send newsletters to annuitants 0 times per year. To achieve a perfect service score you must send newsletters to annuitants 2 or more times per year.                                                                           | + 1.3                 |

CEM is not recommending these changes. Higher service is not necessarily optimal or cost effective. We include this summary analysis because many participants want to know what they would have to do to achieve a higher score.

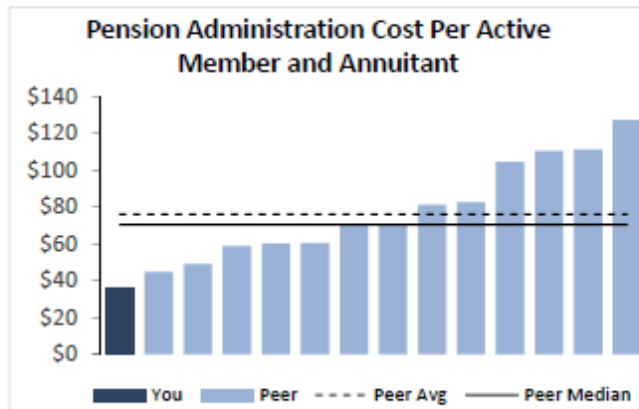
## Appendix B: 2013 CEM Benchmarking Report Executive Summary

The biggest service improvement for most systems has been improved online capabilities.

| Online Tool                                                             | % offering tool |      |      | If offered: Volume per 1,000 active members and annuitants |             |            |
|-------------------------------------------------------------------------|-----------------|------|------|------------------------------------------------------------|-------------|------------|
|                                                                         | You             | Peer | All  | You                                                        | Peer Median | All Median |
| Benefit calculators                                                     |                 |      |      |                                                            |             |            |
| In non-secure area                                                      | Yes             | 64%  | 53%  | 259.5                                                      | 259.5       | 273.5      |
| In secure area not linked to member data                                | No              | 21%  | 9%   | n/a                                                        | 24.4        | 53.3       |
| In secure area linked to member's salary and service data               | No              | 86%  | 87%  | n/a                                                        | 441.6       | 349.0      |
| Service credit purchase calculator                                      | Yes             | 71%  | 68%  | 1.6                                                        | 34.2        | 67.4       |
| Download forms                                                          | Yes             | 100% | 100% | 210.2                                                      | 286.0       | 231.6      |
| Register for counseling sessions                                        | No              | 30%  | 31%  | n/a                                                        | 11.2        | 4.7        |
| Register for presentations                                              | Yes             | 80%  | 66%  | 4.0                                                        | 11.7        | 15.7       |
| Change address                                                          | Yes             | 86%  | 80%  | 9.5                                                        | 18.2        | 26.6       |
| Change beneficiary                                                      | No              | 43%  | 47%  | n/a                                                        | 20.2        | 40.6       |
| Change family information                                               | No              | 36%  | 28%  | n/a                                                        | 108.5       | 53.9       |
| Tools for annuitants                                                    |                 |      |      |                                                            |             |            |
| Change banking information for direct deposit                           | Yes             | 50%  | 43%  | 4.3                                                        | 5.3         | 4.2        |
| Change tax withholding amount                                           | Yes             | 64%  | 44%  | 4.3                                                        | 8.7         | 8.0        |
| Download or print duplicate tax receipts                                | Yes             | 86%  | 69%  | 40.7                                                       | 34.2        | 29.8       |
| View annuity payment details                                            | Yes             | 93%  | 75%  | 157.7                                                      | 177.7       | 130.6      |
| Apply for retirement                                                    | No              | 57%  | 38%  | n/a                                                        | 6.4         | 6.4        |
| View status of disability application                                   | No              | 14%  | 7%   | n/a                                                        | 26.9        | 26.3       |
| Secure mailbox                                                          | Yes             | 57%  | 42%  | 23.8                                                       | 80.1        | 80.6       |
| Download member statement                                               | Yes             | 86%  | 85%  | 253.7                                                      | 208.4       | 168.0      |
| View pensionable earnings and/or service without downloading            | Yes             | 86%  | 87%  | 94.0                                                       | 760.0       | 669.2      |
| If yes:                                                                 |                 |      |      |                                                            |             |            |
| Are both salary and service data available?                             | No              | 92%  | 94%  |                                                            |             |            |
| Is online data up-to-date to the most recent pay period?                | Yes             | 83%  | 73%  |                                                            |             |            |
| Is a complete annual history from the beginning of employment provided? | Yes             | 75%  | 56%  |                                                            |             |            |

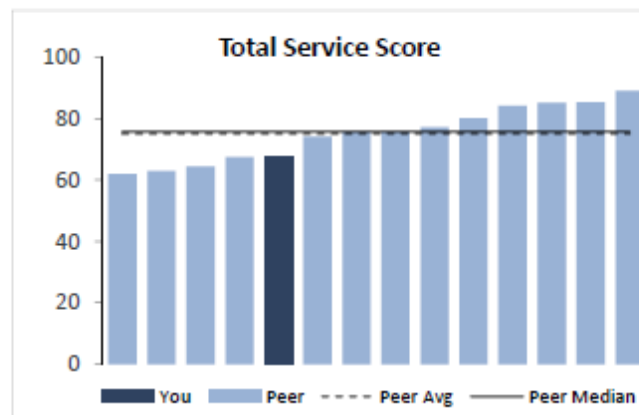
## Appendix B: 2013 CEM Benchmarking Report Executive Summary

### Key Takeaways:



Your total pension administration cost was \$35 per active member and annuitant. This was \$41 below the peer average of \$76 and the lowest cost among your peers. The primary reasons why were:

- You had lower costs per FTE for: salaries and benefits, building and utilities, HR and IT desktop.
- You paid less for back office activities, such as: governance and financial control, major projects, IT strategy, database and applications, and actuarial, legal, audit and other support services.



Your total service score was 68. This was below the peer median of 76. Your score was impacted by a service activity that is highly weighted in the overall score:

- Call Center. You have a high percentage of undesired call outcomes and a high call wait time.

However, your recent enhancements to your website are reflected in your high number of online transaction tools, 10 versus a peer average of 8.

**South Carolina  
Public Employee Benefit Authority (PEBA)  
Retirement Administration Agency  
Peer Benchmarking Results**

January 2015



## Background

- This benchmarking survey was conducted on behalf of the South Carolina Public Employee Benefit Authority (PEBA) by Funston Advisory Services LLC (FAS)
- The targeted peer group consisted of public retirement systems which administer retirement benefits and are separate from the agencies which manage fund investments
- The survey information contained in this report was collected through an online survey administered during November and December 2014

### Summary of Leading Practices

- Based upon the results of this benchmarking survey, other benchmarking studies FAS has conducted with public retirement systems, and the experience of the FAS team, we have identified a number of leading practices for public retirement administration agencies

#### **Board Policies, Practices and Compliance**

- Staggered terms for appointed and elected trustees to ensure continuity
- Minimum three-year terms for trustees
- A formal, independent process to remove a trustee for cause
- Retirement agency Executive Director, or other agency representative, membership on the investment management trustee board
- Separate Board Audit Committee to oversee independent reassurance
- New trustee orientation which includes, at a minimum, ethics, fiduciary responsibilities and governance as topics
- A facilitated annual board self-assessment process which includes upward evaluation from staff and individual feedback to members
- A formal trustee education and training program and budget
- Formalized policies which are reviewed at least every three years
- A state ethics panel or commission to monitor ethics compliance

### Summary of Leading Practices

- Based upon the results of this benchmarking survey, other benchmarking studies FAS has conducted with public retirement systems, and the experience of the FAS team, we have identified a number of leading practices for public retirement administration agencies

#### **Legal and Other Authorities**

- Retirement agency authority to engage legal counsel, the external auditor and other major service providers
- Retirement agency Board of Trustees authority to set all actuarial assumptions for the system
- Investment management and custodian responsibilities for all retirement and insurance funds vested in the investment management trustee board
- Use of outside counsel support in the areas of legal compliance, fiduciary issues, and litigation and eligibility claims
- Trustees are legally indemnified for damages and lawsuits arising from retirement agency business

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Summary of Leading Practices

- Based upon the results of this benchmarking survey, other benchmarking studies FAS has conducted with public retirement systems, and the experience of the FAS team, we have identified a number of leading practices for public retirement administration agencies

#### **Organization and Operations**

- An agency Executive Director as the sole direct operating report to the Board of Trustees
- An executive position responsible for all retirement programs
- For agencies which offer insurance, an executive position responsible for all insurance programs
- An executive position responsible for internal audit with a direct reporting relationship to the Board of Trustees
- Formal staff training plans for customer service, retirement administration, and health administration (if applicable)
- New employee orientation administered by the Human Resources Department
- A structured framework, such as an enterprise risk management program, for assessing, responding to and reporting on risks
- The Executive Director leads strategic planning efforts with input from the Board and support from the executive team
- A fully-documented, tested disaster recovery plan with a hot backup site

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Benchmarking Topics

|                                |    |
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## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Participant Profile

- Participants in the benchmarking survey included only public retirement systems which are separate from the agencies which manage fund investments.
- Among the seven agencies participated in this study:
  - Five oversee defined contribution plans
  - Five administer health insurance
  - Three oversee other insurance programs

| Participating Public Retirement Administration Agencies      | Number of DB Plans | Other Plans Offered |                  |                |                |
|--------------------------------------------------------------|--------------------|---------------------|------------------|----------------|----------------|
|                                                              |                    | DC Plans            | Health Insurance | Long-Term Care | Life Insurance |
| Los Angeles County Employees Retirement Association (LACERA) | 1                  |                     | X                |                |                |
| Minnesota State Retirement System                            | 7                  | X                   |                  |                |                |
| North Carolina Retirement Systems                            | 7                  | X                   | X                | X              | X              |
| Oregon Public Employees Retirement System (Oregon PERS)      | 3                  | X                   | X                |                |                |
| Employees' Retirement System of Rhode Island (ERSRI)         | 5                  | X                   |                  |                |                |
| South Carolina Public Employee benefit Authority (PEBA)      | 8                  | X                   | X                | X              | X              |
| Wisconsin Department of Employee Trust Funds (ETF)           | 1                  |                     | X                | X              | X              |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Participant Profile

- The number of retirement members across classes and plans varies significantly from one peer retirement system to another

| Participating Public Retirement Administration Agencies      | DB Members (000) |          |         | DC Members (000) |          | VSP Members (000) |          |
|--------------------------------------------------------------|------------------|----------|---------|------------------|----------|-------------------|----------|
|                                                              | Active           | Inactive | Annuity | Active           | Inactive | Active            | Inactive |
| Los Angeles County Employees Retirement Association (LACERA) | 92               | 8        | 59      | 0                | 0        | 0                 | 0        |
| Minnesota State Retirement System                            | 55               | 16       | 35      | 14               | 1        | 50                | 30       |
| North Carolina Retirement Systems                            | 483              | 182      | 263     | 296              | 59       | 0                 | 0        |
| Oregon Public Employees Retirement System (Oregon PERS)      | 162              | 41       | 128     | 19               | 6        | 0                 | 0        |
| Employees' Retirement System of Rhode Island (ERSRI)         | 32               | 8        | 27      | 32               | 0        | 0                 | 0        |
| South Carolina Public Employee benefit Authority (PEBA)      | 225              | 171      | 153     | 25               | 16       | 102               | 0        |
| Wisconsin Department of Employee Trust Funds (ETF)           | 252              | 158      | 185     | 0                | 0        | 55                | 0        |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Participant Profile

- Of the five peer retirement systems which administer health care insurance:
  - Three manage health insurance for active employees
  - All manage insurance for retirees

| Participating Public Retirement Administration Agencies      | Health Insurance Subscribers (000) |           |                |                     |
|--------------------------------------------------------------|------------------------------------|-----------|----------------|---------------------|
|                                                              | Active                             | Annuitant | COBRA or Other | Spouse and Children |
| Los Angeles County Employees Retirement Association (LACERA) | NA                                 | 46        | NA             | 47                  |
| Minnesota State Retirement System                            | NA                                 | NA        | NA             | NA                  |
| North Carolina Retirement Systems                            | 311                                | 187       | 1              | 181                 |
| Oregon Public Employees Retirement System (Oregon PERS)      | NA                                 | 48        | NA             | 11                  |
| Employees' Retirement System of Rhode Island (ERSRI)         | NA                                 | NA        | NA             | NA                  |
| South Carolina Public Employee benefit Authority (PEBA)      | 180                                | 79        | 3              | 197                 |
| Wisconsin Department of Employee Trust Funds (ETF)           | 83                                 | 28        | 0.4            | 141                 |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Participant Profile

- There is a significant range in the number of employers supported among the peer group

| Participating Public Retirement Administration Agencies      | Number of Employers Served |                      |
|--------------------------------------------------------------|----------------------------|----------------------|
|                                                              | Retirement                 | Health and Insurance |
| Los Angeles County Employees Retirement Association (LACERA) | 5                          | 5                    |
| Minnesota State Retirement System                            | 600                        | NA                   |
| North Carolina Retirement Systems                            | 2,993                      | 305                  |
| Oregon Public Employees Retirement System (Oregon PERS)      | 925                        | 925                  |
| Employees' Retirement System of Rhode Island (ERSRI)         | 161                        | NA                   |
| South Carolina Public Employee benefit Authority (PEBA)      | 810                        | 678                  |
| Wisconsin Department of Employee Trust Funds (ETF)           | 1,479                      | 362                  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Staffing Profile

- PEBA is near the median in staffing in most functional areas

| Function                                 | Number of Employees |      |        |      |
|------------------------------------------|---------------------|------|--------|------|
|                                          | Low                 | High | Median | PEBA |
| Retirement administration                | 4                   | 110  | 62     | 66   |
| Health and insurance administration      | 0                   | 34   | 28     | 34   |
| Member services                          | 12                  | 107  | 64     | 61   |
| Employer services                        | 0                   | 45   | 4      | 4    |
| Information technology                   | 2                   | 72   | 35     | 35   |
| Legal                                    | 1                   | 17   | 7      | 8    |
| Finance and accounting                   | 5                   | 89   | 29     | 29   |
| Other general administration and support | 4                   | 60   | 25     | 14   |
| Other                                    | 0                   | 73   | 6      | 0    |
| Total                                    | 29                  | 402  | 270    | 251  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Staffing Profile

- On a normalized basis, PEBA is near or below the median in staffing in most functional areas
- Areas where PEBA staffing appears to be lower on a normalized basis are:
  - Employer services
  - Finance and Accounting

| Function                                                           | Number of Employees |       |        |      |
|--------------------------------------------------------------------|---------------------|-------|--------|------|
|                                                                    | Low                 | High  | Median | PEBA |
| Retirement Administration FTEs per 100,000 DB Members              | 2.7                 | 122.2 | 17.5   | 17.5 |
| Health & Insurance FTEs per 100,000 Lives Covered *                | 0.0                 | 22.5  | 7.4    | 7.4  |
| Member Services FTEs per 100,000 DB Members + Lives Covered *      | 68.2                | 261.1 | 75.0   | 72.9 |
| Employer Services FTEs per 1,000 Employers                         | 0                   | 24.3  | 6.2    | 2.7  |
| IT FTEs per 100,000 DB Members                                     | 3.4                 | 32.3  | 9.3    | 9.3  |
| Legal FTEs per 100,000 DB Members                                  | 0.3                 | 11.2  | 1.7    | 2.1  |
| Finance and Accounting FTEs per 100,000 DB Members + Lives Covered | 3.0                 | 22.8  | 8.5    | 3.5  |
| Total FTEs per 100,000 DB Members                                  | 49.1                | 265.0 | 66.5   | 66.5 |
| Total FTEs per 100,000 DB Members + Lives Covered *                | 25.7                | 164.0 | 39.2   | 30.0 |

\* Excludes two agencies which do not administer health insurance

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Composition

- The typical retirement agency Board has a mix of ex-officio, appointed and elected members
- PEBA is unusual in that it has all appointed members; only one of the other peer boards is entirely appointed
- Four of the seven peer boards have elected members

|                          | Ex-Officio |     |     |      | Appointed |     |     |      | Elected |     |     |      | Total |     |     |      |
|--------------------------|------------|-----|-----|------|-----------|-----|-----|------|---------|-----|-----|------|-------|-----|-----|------|
|                          | Min        | Max | Med | PEBA | Min       | Max | Med | PEBA | Min     | Max | Med | PEBA | Min   | Max | Med | PEBA |
| State Officers           | 0          | 3   | 1   | 0    | 0         | 1   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 3   | 1   | 0    |
| Plan Participants        | 0          | 0   | 0   | 0    | 0         | 6   | 1   | 3    | 0       | 6   | 1   | 0    | 1     | 6   | 5   | 3    |
| Retirees                 | 0          | 0   | 0   | 0    | 0         | 2   | 0   | 1    | 0       | 2   | 1   | 0    | 0     | 2   | 1   | 1    |
| Members of the Public    | 0          | 0   | 0   | 0    | 1         | 7   | 4   | 7    | 0       | 0   | 0   | 0    | 1     | 7   | 4   | 7    |
| Industry Representatives | 0          | 0   | 0   | 0    | 0         | 0   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 0   | 0   | 0    |
| Employer Representatives | 0          | 1   | 0   | 0    | 0         | 2   | 0   | 0    | 0       | 0   | 0   | 0    | 0     | 2   | 0   | 0    |
| Total                    | 0          | 4   | 1   | 0    | 4         | 11  | 5   | 11   | 0       | 7   | 2   | 0    | 5     | 15  | 11  | 11   |

Note: Two of the peer agencies have multiple retirement boards; numbers reflect the largest

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Composition

- In the four states with qualifications for appointed members, the specification varies significantly from one to another
- South Carolina has by far the most stringent qualification for appointed board members

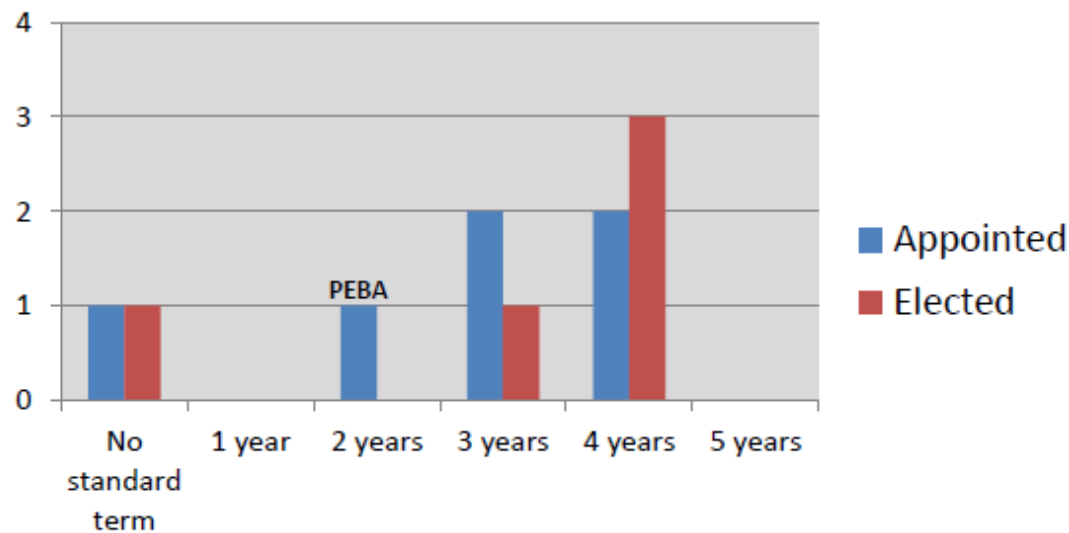
| Appointed members. N=6                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Yes | No | Not Applicable |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----|----------------|
| Are specific qualifications required for trustees? If so, what are they?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | 4   | 2  | 1              |
| Comments:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |     |    |                |
| Must be competent by training or experience in finance, accounting or pensions.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |     |    |                |
| One must have at least five years of experience in actuarial analysis, administration of an employee benefit plan, or significant administrative responsibility in a major insurer                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |     |    |                |
| Three members of the board must have experience in business management, pension management or investing.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |     |    |                |
| <p>PEBA: A non-representative member may not be appointed to the board unless the person possesses at least one of the following qualifications: (a) at least twelve years of professional experience in the financial management of pensions or insurance plans; (b) at least twelve years academic experience and holds a bachelor's or higher degree from a college or university as classified by the Carnegie Foundation; (c) at least twelve years of professional experience as a certified public accountant with financial management, pension, or insurance audit expertise; (d) at least twelve years as a Certified Financial Planner credentialed by the Certified Financial Planner Board of Standards; or (e) at least twelve years membership in the South Carolina Bar and extensive experience in one or more of the following areas of law: (i) taxation; (ii) insurance; (iii) health care; (iv) securities; (v) corporate; (vi) finance; or (vii) the Employment Retirement Income Security Act (ERISA). (2) A representative member may not be appointed to the board unless the person: (a) possesses one of the qualifications set forth in item (1); or (b) has at least twelve years of public employment experience and holds a bachelor's degree from a college or university as classified by the Carnegie Foundation.</p> |     |    |                |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Composition

- PEBA is the only agency in the peer group with a board term as short as two years
- The most prevalent board member term is four years
- In addition, leading practice is to stagger trustee terms for improved continuity
- None of the peer agencies have term or age limits for board members

Is there a standard length of an elected or appointed trustee's term?



|                                                   | Yes | No |
|---------------------------------------------------|-----|----|
| Are trustee terms staggered to ensure continuity? | 5   | 2  |

Green shading indicates PEBA response

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Composition

- PEBA is the only agency in the peer group which allows for removal of trustees by either the Governor or the appointing authority
- At two peer agencies the Board or Board Chair can remove a trustee for cause

| Can a trustee be removed for any reason, including for cause? (n=5 – two indicated laws are unclear) | Yes | No |
|------------------------------------------------------------------------------------------------------|-----|----|
| By the Governor                                                                                      | 1   | 4  |
| By the Legislature                                                                                   | 0   | 5  |
| By the State Attorney General                                                                        | 0   | 5  |
| By the trustee's appointing authority                                                                | 1   | 4  |
| By fellow trustees                                                                                   | 2   | 3  |

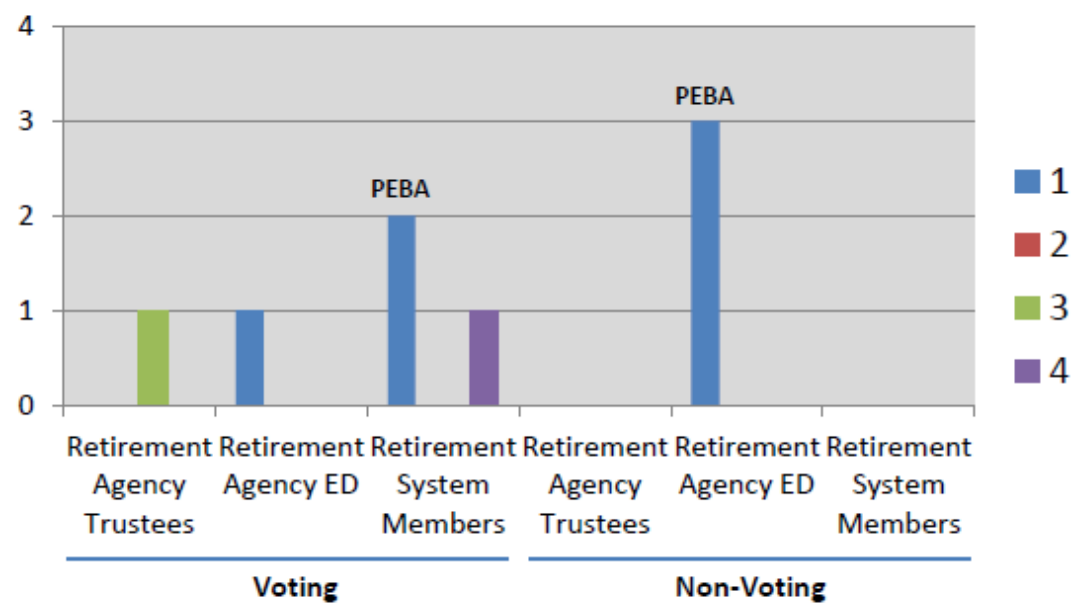
Green shading indicates  
PEBA response

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Composition

- There is no clear pattern of voting or non-voting representation on the investment board by retirement agency trustees, the executive director, or system active or retired members
- PEBA appears to be as typical as any with one retired member as a voting member and the agency ED as a non-voting member on the Investment Commission

Do any of the following have a trustee role on the investment board which manages your system's assets?



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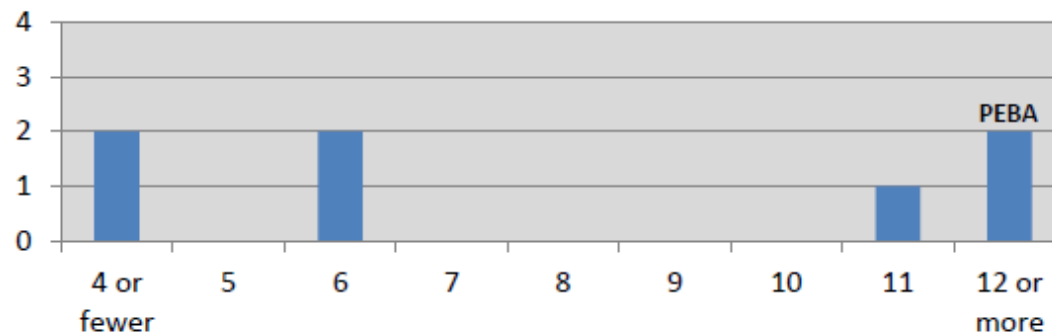
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## Appendix C: FAS Benchmarking Survey of PEBA Peers

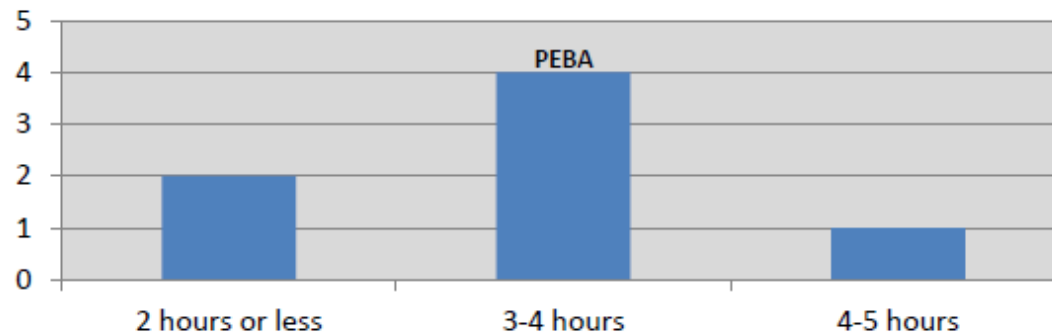
### Board Practices

- Four of the peer agency boards meet six times annually or less
- Three of the agencies, including PEBA meet 11 or more times per year (one meets twice monthly)
- PEBA board meetings, at 3-4 hours in length, are typical for the peer group

On average, how many times has your Board met annually over the past three years?



What is the typical duration of a meeting of the full Board?



## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Practices

- A separate Audit Committee is the most common board committee in the peer group
- Only two peer agencies have committees which have decision-making responsibilities
- One peer agency has no board committees and always meets as a whole

| Please indicate if your Board has any of the following committees and if they are voting or advisory. | N = 7  |          | Average           |                          |
|-------------------------------------------------------------------------------------------------------|--------|----------|-------------------|--------------------------|
|                                                                                                       | Voting | Advisory | Meetings Annually | Meeting Duration (hours) |
| Audit                                                                                                 | 0      | 4        | 3                 | 2                        |
| Compensation/Personnel                                                                                | 0      | 1        | 2                 | 1                        |
| Pension Benefits/Actuarial                                                                            | 1      | 1        | 12                | 2                        |
| Health Benefits                                                                                       | 1      | 1        | 12                | 2                        |
| Finance/Budget                                                                                        | 1      | 1        | 3                 | 1                        |
| Appeals/Disability Review                                                                             | 1      | 2        | 12                | 3.5                      |
| Executive                                                                                             | 0      | 1        | 4                 | 2                        |
| Policy/External Affairs                                                                               | 0      | 1        | 2                 | 2                        |
| Administrative                                                                                        | 0      | 1        | 12                | 1                        |
| Legislation                                                                                           | 0      | 2        | 2                 | 1.5                      |
| Finance, Administration, Audit and Compliance                                                         | 1      | 0        | 12                | 2.5                      |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Practices

- Two of the peer agencies have an Board agenda time for members of the public to make statements
- In contrast to many public pension funds with investment management responsibilities, none in this peer group of retirement agencies broadcasts or records its board meetings

|                                                                                                                                   | Yes | No |
|-----------------------------------------------------------------------------------------------------------------------------------|-----|----|
| Do your Board meetings typically include a time period on the agenda when members of the public are permitted to make statements? | 2   | 5  |
| Comment: No, but members can if they want.                                                                                        |     |    |

| Are Board meetings broadcast and/or recorded and made available on the agency's website? | Yes | No |
|------------------------------------------------------------------------------------------|-----|----|
| Broadcast with live audio only                                                           | 0   | 7  |
| Broadcast with live video                                                                | 0   | 7  |
| Audio recording available on your website                                                | 0   | 7  |
| Video recording available on your website                                                | 0   | 7  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Practices

- Among the peer group, the Executive Director typically develops the draft Board agenda and the Board provides feedback
- Most peer agencies do not have position descriptions for board duties

| Which statement most closely describes how the Board agenda is set?                                                                              | Yes |
|--------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| The chair prepares the draft agenda and asks the Board and Executive Director/CEO for feedback                                                   | 0   |
| The Executive Director/CEO prepares the draft agenda and asks the Board for feedback                                                             | 5   |
| Board members and the Executive Director/CEO submit their requests to the chair and the chair finalizes the agenda                               | 1   |
| Staff prepare the agenda and distribute to the Board. Board members may request to include specific agenda items provided the request is timely. | 1   |

| Does your board have position descriptions for: | Yes | No |
|-------------------------------------------------|-----|----|
| Board members                                   | 0   | 7  |
| Board and committee officers                    | 1   | 6  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Practices

- All but one other peer agency provides new board member orientation
- All new member orientation at peer agencies includes:
  - Ethics
  - Fiduciary
  - Governance

| Is there a formal orientation process for new board members? If yes, what topics are covered? Please indicate all that apply. | Yes |
|-------------------------------------------------------------------------------------------------------------------------------|-----|
| Ethics                                                                                                                        | 5   |
| Fiduciary                                                                                                                     | 5   |
| Strategy                                                                                                                      | 2   |
| Pension administration                                                                                                        | 4   |
| Health insurance                                                                                                              | 3   |
| Public relations                                                                                                              | 1   |
| Board leadership                                                                                                              | 3   |
| Governance                                                                                                                    | 5   |
| No new board member orientation                                                                                               | 2   |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Self-Assessment

- PEBA and one other peer agency perform an annual self-assessment of the entire board
- None of the agencies have committee or individual member self-assessments

| Does the board conduct regular self-assessments of its effectiveness? If yes, which of the following does it regularly assess and with what frequency? Please indicate all that apply. | Annually | Biennially | No Self-Assessment |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|------------|--------------------|
| Board as a whole                                                                                                                                                                       | 2        | 0          | 5                  |
| Individual committees                                                                                                                                                                  | 0        | 0          | 7                  |
| Individual members                                                                                                                                                                     | 0        | 0          | 7                  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Board Education

- All of the peer agencies offer board training whether it is legally mandated or not
- Only one state has a statute which identifies what type of training must be offered and specifies:
  - Ethics
  - Fiduciary
  - Strategy
  - Pension Administration
  - Governance

| Is education and training provided for your board members? | N = 7 | Minimum Hours Required |
|------------------------------------------------------------|-------|------------------------|
| Yes, it is required by statute                             | 3     | 8 / 8 / 12             |
| Yes, it is required by board policy                        | 1     | 9                      |
| Yes, but it is not mandated                                | 3     |                        |
| No, we do not offer board training                         |       |                        |

| Are board members required to report back on external training sessions attended?       | N = 7 |
|-----------------------------------------------------------------------------------------|-------|
| Yes                                                                                     | 1     |
| No                                                                                      | 6     |
| Comment: No, but Education Policy encourages trustees to report during Board meeting    |       |
| Comment: No, It is not required by policy, however, our board Chair asks for reporting. |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Policies

- Similar to many of the peer agencies, PEBA does not have defined policies in a number of areas
- Leading practice in most of these areas is to have a well-considered policy statement

| Please indicate whether your system has the following policies and, if so, if they are defined by the Board or in state statute. | Board-defined policy | Defined in statute | Defined by a state agency | Staff-defined policy | No defined policy |
|----------------------------------------------------------------------------------------------------------------------------------|----------------------|--------------------|---------------------------|----------------------|-------------------|
| Audit policy                                                                                                                     | 5                    | 1                  | 1                         |                      |                   |
| Board contacts with staff and requests for information                                                                           | 2                    |                    |                           | 1                    | 4                 |
| Board education policy                                                                                                           | 5                    | 1                  | 1                         |                      |                   |
| Board ethics and standards of conduct                                                                                            | 3                    | 4                  |                           |                      |                   |
| Board member financial interests                                                                                                 | 1                    | 6                  |                           |                      |                   |
| Board self-assessment policy                                                                                                     |                      |                    | 2                         |                      | 5                 |
| Business continuity policy                                                                                                       | 1                    |                    | 1                         | 1                    | 4                 |
| Claims and appeals policies                                                                                                      | 2                    | 5                  |                           |                      |                   |
| Communications policy                                                                                                            | 1                    |                    | 1                         |                      | 5                 |
| Compensation policy                                                                                                              |                      | 1                  | 1                         |                      | 5                 |
| Contacts with board members during RFP process and reporting                                                                     | 1                    | 2                  | 1                         |                      | 3                 |
| Customer service policy                                                                                                          | 1                    |                    |                           | 1                    | 5                 |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Policies

- Similar to many of the peer agencies, PEBA does not have defined policies in a number of areas
- Leading practice in most of these areas is to have a well-considered policy statement

| Please indicate whether your system has the following policies and, if so, if they are defined by the Board or in state statute. | Board-defined policy | Defined in statute | Defined by a state agency | Staff-defined policy | No defined policy |
|----------------------------------------------------------------------------------------------------------------------------------|----------------------|--------------------|---------------------------|----------------------|-------------------|
| Data integrity policy                                                                                                            | 1                    | 1                  |                           |                      | 5                 |
| Document retention policy                                                                                                        | 2                    | 1                  | 4                         |                      |                   |
| Expense reimbursement policy                                                                                                     | 1                    | 2                  | 4                         |                      |                   |
| Funding and valuation policies                                                                                                   | 1                    | 5                  |                           |                      | 1                 |
| Gift policy                                                                                                                      |                      | 4                  | 1                         |                      | 2                 |
| Human resources policy                                                                                                           |                      | 1                  | 2                         | 1                    | 2                 |
| Indemnification/insurance policy                                                                                                 |                      | 3                  |                           | 1                    | 3                 |
| Privacy policy                                                                                                                   | 1                    | 4                  |                           | 1                    | 1                 |
| Procurement policy                                                                                                               | 2                    | 3                  | 2                         |                      |                   |
| Risk management policy                                                                                                           | 1                    |                    | 1                         |                      | 5                 |
| Vendor referrals by Board members                                                                                                |                      | 1                  |                           | 1                    | 5                 |
| Whistleblower and/or complaint handling policy                                                                                   | 1                    | 2                  | 2                         |                      | 2                 |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Policies

- All of the peer state agencies have an Ethics Commission or Panel which monitor ethics compliance; one county agency does not

| Is there an external authority that monitors and enforces board compliance with ethics and standards of conduct policies? | N = 7 |
|---------------------------------------------------------------------------------------------------------------------------|-------|
| Yes, the Attorney General monitors compliance                                                                             | 0     |
| Yes, the state has an Ethics Commission or Panel which monitors compliance                                                | 6     |
| No, the agency Board of Trustees has a self-monitoring process handled by a committee                                     | 0     |
| No                                                                                                                        | 1     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Policies

- Some of the peer agencies have more authority to engage outside legal counsel and, especially, engage the external auditor and set legal premiums

| Does the Board of Trustees for your agency have the authority (even if it is delegated to staff), without necessary approvals from any outside body, to: | Yes | No | NA |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----|----|
| Engage outside legal counsel                                                                                                                             | 2   | 4  | 1  |
| Engage the external auditor                                                                                                                              | 4   | 2  | 1  |
| Set insurance premiums                                                                                                                                   | 3   | 1  | 3  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Authorities

- Although several peer agencies have more budgeting flexibility, PEBA's budgeting authorities are typical for the peer group

| Which statement best describes your organization's process for establishing its annual operating budget and spending authority? | N = 7 |
|---------------------------------------------------------------------------------------------------------------------------------|-------|
| Our retirement system trustees have the authority to set our budget without legislative approval                                | 1     |
| Our retirement system trustees establish our budget and report it to the legislature                                            | 0     |
| Our retirement system trustees establish our budget and submit it to the legislature for approval                               | 1     |
| Our retirement system is part of the annual state budget setting process                                                        | 4     |
| Our retirement system trustees can budget and spend up to a fixed percentage of our plan liability without legislative review   | 1     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Authorities

- Although several peer agencies have more budgeting flexibility, PEBA's headcount authorities are also typical for the peer group

| Which statement best describes your organization's ability to hire additional internal staff?                                              | N = 7 |
|--------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Our retirement system trustees have the authority to allow us to hire as we believe to be prudent                                          | 2     |
| Our retirement system trustees must receive approval to add headcount from the legislature or an executive state agency                    | 4     |
| Our retirement system trustees can allow hiring of additional internal headcount as long as we remain within our authorized spending level | 0     |
| Board only hires Executive and Deputy Director. All other employees are Treasury appointed or union employees.                             | 1     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Authorities

- The peer group staff compensation is typically subject to constraints imposed by a state agency or the legislature

| Which statement best describes your organization's ability to set internal staff compensation?                                                       | N = 7 |
|------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Our retirement system trustees have full authority to set staff compensation                                                                         | 2     |
| Our retirement system trustees have authority to set compensation for some, but not all, positions, subject to approval by an executive state agency | 1     |
| With the exception of defined exempt positions, our staff compensation must be within defined ranges set by the legislature                          | 0     |
| Our staff compensation must be within ranges set by the legislature and there are staff compensation limits at every level                           | 2     |
| Compensation ranges and position classification are set by an executive state agency                                                                 | 1     |
| Set by law or other agency                                                                                                                           | 1     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Authorities

- Although the legislature sets the assumed rate of return for the system at one peer system, the more prevalent practice is for the retirement agency board of trustees to make the decision

| Who has final authority for setting the assumed rate of return for system ? | N = 7 |
|-----------------------------------------------------------------------------|-------|
| The legislature                                                             | 2     |
| Retirement system board of trustees                                         | 4     |
| Investment board trustees                                                   | 1     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Authorities

- The State Auditor selection of the external auditor is typical for the peer group
- Approval authorities of fund valuations and the final CAFR vary across the peer group

| Who is responsible for making the following decisions?                                                                                                                                                                                                        | Investment Board Trustees | Retirement Agency Trustees | State Auditor General | State Treasurer | Other                                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------------------|-----------------------|-----------------|---------------------------------------------|
| Approving the investment fund valuations reported in the CAFR                                                                                                                                                                                                 | 3                         | 1                          | 1                     |                 | 2 <sup>1/</sup> <sup>2/</sup>               |
| Approving the final CAFR                                                                                                                                                                                                                                      |                           | 2                          | 2                     |                 | 3 <sup>1/</sup> <sup>2/</sup> <sup>3/</sup> |
| Selection of the external auditor                                                                                                                                                                                                                             |                           | 2                          | 5                     |                 |                                             |
| <sup>1/</sup> Investment valuations and the CAFR are delegated tasks for staff to complete. The Board of Investments reviews and discusses the investment reports, however, there is no formal approval                                                       |                           |                            |                       |                 |                                             |
| <sup>2/</sup> The investment fund valuations are approved by a joint valuation committee of the staff of our investment board and PEBA. The valuations are not approved by the respective boards. Approval of the final CAFR is done at the PEBA staff level. |                           |                            |                       |                 |                                             |
| <sup>3/</sup> Final CAFR is approved by the Executive Director.                                                                                                                                                                                               |                           |                            |                       |                 |                                             |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Role of the State Treasurer

- Although the State Treasurer has fiduciary and custodial roles in a few states, it is not the prevailing practice

| Which of the following statements reflect the role of the State Treasurer with respect to your agency? Please check all that apply. | N = 7 |
|-------------------------------------------------------------------------------------------------------------------------------------|-------|
| The Treasurer is the sole fiduciary                                                                                                 | 1     |
| The Treasurer is a co-fiduciary                                                                                                     | 2     |
| The Treasurer manages retirement system investments for our defined benefit plan                                                    | 2     |
| The Treasurer manages retirement system investments for our defined contribution plan                                               | 1     |
| The Treasurer manages investments for our insurance benefit funds                                                                   | 2     |
| The Treasurer is the custodian of our defined benefit plan funds                                                                    | 3     |
| The Treasurer is the custodian of our defined contribution plan funds                                                               | 1     |
| The Treasurer is the custodian of our insurance benefit funds                                                                       | 2     |
| Comment: Our state abolished the State Treasurer position                                                                           |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Legal

- PEBA's use of outside legal counsel appears to be typical for the peer group of agencies

| For which type of legal issues does your agency typically retain outside counsel? | Yes | No |
|-----------------------------------------------------------------------------------|-----|----|
| Due diligence                                                                     | 2   | 5  |
| Contracting or purchasing                                                         | 2   | 5  |
| Fiduciary issues                                                                  | 5   | 2  |
| Litigation and eligibility claims                                                 | 5   | 2  |
| Legal compliance                                                                  | 6   | 1  |

| What has been the average annual spending on outside counsel over the past three years? | \$(000) |
|-----------------------------------------------------------------------------------------|---------|
| High                                                                                    | \$250   |
| Low                                                                                     | \$25    |
| Median                                                                                  | \$120   |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Legal

- Most peer agencies indemnify their Board members for damages and lawsuits
- PEBA is one of two in the peer group who purchase commercial indemnity insurance

| Are your trustees indemnified for damages and lawsuits arising from retirement system business; if so, is this required under state statute or through Board policy? |   |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|
| Yes, required under state statutes                                                                                                                                   | 6 |
| Yes, required through Board policy                                                                                                                                   | 1 |
| No, our trustees are not indemnified                                                                                                                                 | 0 |

| Please indicate if you self-insure or purchase commercial Directors' and Officers' insurance. |              |
|-----------------------------------------------------------------------------------------------|--------------|
| We self-insure                                                                                | 4            |
| We purchase commercial insurance                                                              | 2            |
| If your agency has indemnification insurance, what is:                                        |              |
| The total amount of coverage                                                                  | \$25 million |
| The deductible amount                                                                         | \$250k;      |
|                                                                                               | \$1 million  |
| Comment: We self insure through the state risk management pool, to which we pay premiums.     |              |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Organization

- Most peer agencies have a CFO, a leader for retirement programs, and if they offer a health insurance program, a leader for health insurance
- PEBA is unique among the peer group with the Director of Audit reporting directly to the board

| Which of the following positions currently exist within your organization and which report directly to the Board of Trustees? | Position Exists | Direct Report to the Board |
|-------------------------------------------------------------------------------------------------------------------------------|-----------------|----------------------------|
| Executive Director, Secretary or CEO                                                                                          | 7               | 6                          |
| Deputy Executive Director or Chief Operating Officer                                                                          | 7               | 0                          |
| Chief Financial Officer or Director of Finance                                                                                | 5               |                            |
| Chief Retirement Programs Officer                                                                                             | 5               |                            |
| Chief Insurance Programs Officer                                                                                              | 3               |                            |
| Chief Technology Officer                                                                                                      | 6               |                            |
| Chief Administrative Officer                                                                                                  | 3               |                            |
| Chief Legal Officer or General Counsel                                                                                        | 6               |                            |
| Chief Risk Officer                                                                                                            | 1               |                            |
| Chief Compliance Officer                                                                                                      | 1               |                            |
| Chief Auditor or Director of Audit                                                                                            | 5               | 1                          |
| Chief Information Security Officer                                                                                            | 4               |                            |
| Chief Diversity Officer                                                                                                       | 1               |                            |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Organization

- There is not a clear pattern in the peer group for which department provides employer training
- All the other peer agencies which administer DC plans have the leader of retirement plans administer the DC plans

| Who is responsible for employer training? (some multiple answers)              | N = 7 |
|--------------------------------------------------------------------------------|-------|
| Performed by field audit staff                                                 | 1     |
| Performed by one employer training staff which covers all programs             | 3     |
| Performed by separate insurance and retirement training staffs (if applicable) | 3     |
| Performed by various system staff                                              | 2     |

| Where in your organization does responsibility for defined contribution plans reside? | N = 5 |
|---------------------------------------------------------------------------------------|-------|
| Under the Retirement System Administrator                                             | 4     |
| Under the Chief Financial Officer                                                     | 0     |
| Under the Chief Procurement Officer                                                   | 0     |
| Under retirement systems finance and accounting                                       | 1     |
| Not applicable                                                                        | 2     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Organization

- All but one peer agency has a training plan for retirement administration, and all but one which administers health insurance has a health administration training plan
- Typically the Human Resources Department has an orientation process for new employees

| Does your organization maintain a staff training plan for: | N = 7 |
|------------------------------------------------------------|-------|
| Customer service                                           | 5     |
| Retirement administration                                  | 5     |
| Health administration (if applicable)                      | 3     |

| Who leads the formal orientation process for new employees? (some multiple answers) | N = 7 |
|-------------------------------------------------------------------------------------|-------|
| Human resources                                                                     | 5     |
| Each department for its own employees                                               | 3     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- All of the peer agencies which administer health insurance have a leader of the health insurance function
- Most of the peer group has a single department responsible for:
  - Member services
  - Contracting and procurement (responsible for both retirement and health insurance)

| Which of the following statements apply to your organization? Only the five agencies who offer health insurance responded to these questions. | N = 5 |
|-----------------------------------------------------------------------------------------------------------------------------------------------|-------|
| We have a leader of our retirement programs who has responsibility for all retirement administration operations                               | 2     |
| We have a leader of our health care insurance programs who has responsibility for all health care insurance administration operations         | 4     |
| We utilize a single member services function for all active and retired members                                                               | 3     |
| We utilize a single employer services function for all employers                                                                              | 2     |
| We utilize a separate contracting and procurement department to support both retirement administration and health care plan administration    | 3     |
| We utilize a single function to manage dormant accounts                                                                                       | 0     |
| Comment: We are in the process of replacing our benefits administration system and moving to a more integrated business model.                |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- The typical peer agency with retirement and insurance administration also integrated imaging and employer services

| Which of the following operational functions utilize common personnel, processes and tools for both retirement and health care administration? Only the five agencies who offer health insurance responded to these questions. | N = 5 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Call centers                                                                                                                                                                                                                   | 2     |
| Imaging                                                                                                                                                                                                                        | 3     |
| Procurement                                                                                                                                                                                                                    | 3     |
| Employer services                                                                                                                                                                                                              | 2     |
| Comment: Health insurance administration is for retired members only, so minimal interaction with employer services other than eligibility determinations upon retirement for some subsidies or premium offsets.               |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- PEBA is fairly unique in self-insuring its various health insurance plans
- None of the peer agencies reinsure their self-funded insurance

| How does your agency insure for its primary health care plans? Only the five agencies who offer health insurance responded to these questions. | Insured through a third party | Self-insured |
|------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|--------------|
| PPO's and Other Traditional Coverage Plans (some multiple answers)                                                                             | 4                             | 2            |
| HMO's                                                                                                                                          | 3                             | 1            |
| Medicare Supplement Plans                                                                                                                      | 3                             | 1            |
| Primary Long-Term Disability                                                                                                                   | 1                             | 1            |
| Dental Plans                                                                                                                                   | 3                             | 1            |
| Other (please specify)                                                                                                                         | 0                             | 1            |
| Comment: We offer a self-insured health insurance to our members.                                                                              |                               |              |
| Comment: This agency coordinates coverage plans made available to retired members. We do not provide the insurance ourselves.                  |                               |              |

| Only the five agencies who offer health insurance responded to these questions.    | Yes | No | NA |
|------------------------------------------------------------------------------------|-----|----|----|
| If applicable, does your agency purchase reinsurance for self-funded health plans? | 0   | 4  | 1  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- Peer funds utilize a variety of different sources for consulting input in health care
- There appears to be a consistent pattern that the same consultants are typically used for both health plan strategy and health plan design

| Have you engaged consultants to assist in making improvements in the health plan area? If yes, in which of the following areas and with what type of firm? Please indicate all which apply. Only the five agencies who offer health insurance responded to these questions. | Third party administrator | Actuarial firm | Major consulting firm | Specialist health care consulting firm |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------|-----------------------|----------------------------------------|
| Overall health plan strategy                                                                                                                                                                                                                                                | 1                         | 2              | 2                     | 1                                      |
| Health plan design                                                                                                                                                                                                                                                          | 1                         | 2              | 1                     | 3                                      |
| New program innovation (e.g., wellness, pay-for-performance)                                                                                                                                                                                                                | 0                         | 2              | 1                     | 2                                      |
| Other (please specify)                                                                                                                                                                                                                                                      |                           |                |                       | 1                                      |
| Comment: Evaluating Federal subsidy programs using a specialist firm                                                                                                                                                                                                        |                           |                |                       |                                        |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- Typically the peer agency trustees must seek approval for significant changes in health insurance programs

| Does your Board have the authority to introduce major innovations (e.g., preventive programs, cost sharing) or other significant changes into the health insurance programs without approval from another body? Only the five agencies who offer health insurance responded to these questions. | N = 4 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Yes, our trustees can introduce major innovations without seeking outside approvals                                                                                                                                                                                                             | 2     |
| No, major health plan innovations require approval by the legislature                                                                                                                                                                                                                           | 2     |
| No, major health plan innovations require approval by an executive agency                                                                                                                                                                                                                       | 0     |
| Other (please specify)                                                                                                                                                                                                                                                                          |       |
| Comment: Yes, our trustees can introduce major innovation without seeking outside approvals provided program changes are cost neutral or a cost savings to the participating employers                                                                                                          |       |
| Comment: The Treasurer, who is the Chair of the Board, makes the final approval for such innovations or other significant changes.                                                                                                                                                              |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- There does not appear to be one typical means of developing and operating wellness programs
- All but one of the peer agencies which administer health insurance are offering wellness programs

| <b>If your agency offers wellness programs to its subscribers, how are they developed and operated? Please indicate all that apply. Only the five agencies who offer health insurance responded to these questions.</b> | <b>N = 5</b> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|
| Developed and operated by the retirement system or insurance plan                                                                                                                                                       | 3            |
| Developed and operated as a partnership with key external providers                                                                                                                                                     | 2            |
| Developed and operated by key external providers under contract to the system                                                                                                                                           | 1            |
| We do not offer wellness programs                                                                                                                                                                                       | 1            |
| Other (please specify)                                                                                                                                                                                                  | 2            |
| Comment: These wellness programs are subject to Board approval.                                                                                                                                                         |              |
| Comment: We are offering limited scope wellness benefits now that are funded by the plan (the co-pay waiver and the worksite screening).                                                                                |              |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- There also does not appear to be one typical means of funding wellness programs

| <b>If your agency offers wellness programs to its subscribers, are related wellness program costs paid by (check all applicable), Only the five agencies who offer health insurance responded to these questions.</b> | <b>N = 5</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|
| Health insurance trust funds                                                                                                                                                                                          | 1            |
| General state funds                                                                                                                                                                                                   | 0            |
| Employers                                                                                                                                                                                                             | 0            |
| Employees                                                                                                                                                                                                             | 1            |
| Service providers                                                                                                                                                                                                     | 2            |
| We do not offer wellness programs                                                                                                                                                                                     | 1            |
| Other (please specify)                                                                                                                                                                                                | 2            |
| Comment: Wellness programs are offered through service providers and insurance carriers                                                                                                                               |              |
| Comment: The co-pay waiver and worksite screenings are funded by the plan. However, there are multiple other potential wellness programs that are run by employers and have nothing to do with the plan.              |              |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Health Insurance

- Wellness appears to be the highest priority initiative among the peer group; however, it is too early to evaluate wellness effectiveness
- Generic drug programs appear to have been the most effective initiative on the list
- None of the peer organizations have implemented accountable care organizations, integrated care, or pay-for-performance initiatives

| Please indicate which of the following health care initiatives you have undertaken and which you believe are the most effective for cost containment. Only four agencies who offer health insurance responded to these questions. | Status      |            |             |                 | Priority |        |     | Cost Effectiveness |           |                      |             |                  |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|------------|-------------|-----------------|----------|--------|-----|--------------------|-----------|----------------------|-------------|------------------|
|                                                                                                                                                                                                                                   | Implemented | In-Process | Considering | Not considering | High     | Medium | Low | Highly Effective   | Effective | Marginally Effective | Ineffective | To Be Determined |
| Wellness                                                                                                                                                                                                                          | 2           | 2          |             |                 | 3        | 1      |     |                    | 1         |                      |             | 3                |
| Accountable care organizations                                                                                                                                                                                                    |             | 1          | 1           |                 |          | 1      |     |                    |           |                      |             | 1                |
| Integrated care                                                                                                                                                                                                                   |             |            | 1           |                 |          | 1      |     |                    |           |                      |             | 1                |
| Pay-for-performance                                                                                                                                                                                                               |             |            | 1           |                 |          | 1      |     |                    |           |                      |             | 1                |
| Generic drugs                                                                                                                                                                                                                     | 2           |            | 1           |                 | 2        |        |     | 2                  |           |                      |             | 1                |
| Streamlining administration                                                                                                                                                                                                       | 1           |            |             | 1               | 1        |        | 1   |                    | 1         |                      |             |                  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Communications

- Only two of the seven peer agencies have a documented communications plan

| Does your system have a documented communications plan?         | N = 7 |
|-----------------------------------------------------------------|-------|
| Yes, developed, approved and monitored by the Board             | 0     |
| Yes, developed by staff and approved and monitored by the Board | 1     |
| Yes, developed, approved and monitored by the staff             | 1     |
| No, we do not have a documented communications plan             | 5     |

| If you have a communications plan, does it include strategies for communications with:                | N = 2 |
|-------------------------------------------------------------------------------------------------------|-------|
| Retirees                                                                                              | 2     |
| Active members                                                                                        | 2     |
| Inactive members                                                                                      | 1     |
| Retiree groups                                                                                        | 1     |
| Employer groups                                                                                       | 2     |
| Legislators                                                                                           | 0     |
| Bodies or individuals who appoint Board members                                                       | 0     |
| Oversight committee (if applicable)                                                                   | 0     |
| Media                                                                                                 | 1     |
| Comment: Although we do not have a documented policy/plan, we do have strategies for much of the list |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Communications

- Among the peer agencies, trustees do not appear to have formal communications roles with constituent group; most communications are handled by agency executives or staff

| Who regularly meets with or otherwise communicates with members, retiree groups, and employers and how often does this occur?                                                                                                                                                                                                                                                                                                                                                           | Trustees |          |                    |                   | Agency Executives |          |                    |                   | Agency Staff |          |                    |                   |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|--------------------|-------------------|-------------------|----------|--------------------|-------------------|--------------|----------|--------------------|-------------------|
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Rarely   | Annually | 2-3 times per year | Quarterly or more | Rarely            | Annually | 2-3 times per year | Quarterly or more | Rarely       | Annually | 2-3 times per year | Quarterly or more |
| Members                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |          |          |                    |                   |                   |          |                    | 2                 |              | 1        |                    | 4                 |
| Retirees                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |          |          |                    |                   |                   | 1        |                    | 2                 |              | 1        |                    | 3                 |
| Employers                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |          |          |                    |                   |                   |          | 1                  | 2                 | 1            | 1        |                    | 3                 |
| Comment: Retirement Systems' staff conducts Retirement Planning Conferences for Actives and Employer Training for participating employers across the state throughout the year.                                                                                                                                                                                                                                                                                                         |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |
| Comment: Board meetings are open and members, retirees and employers often attend. Staff regularly meet with all constituent groups.                                                                                                                                                                                                                                                                                                                                                    |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |
| Comment: Staff meet with members along with providing on-site and off-site group counseling sessions, participate in retiree events during the year, and regularly work with the employer in resolving business issues. Agency Executives regularly work with employers to resolve business and benefit issues, present before member and retiree groups. Trustees, particularly those elected by their respective participants, regularly field contacts from participants and unions. |          |          |                    |                   |                   |          |                    |                   |              |          |                    |                   |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Risk

- Similar to PEBA, most of the peer agencies do not have an enterprise risk program and report that they do not systematically consider risk in major Board decisions

| Has your organization adopted a formal Enterprise Risk Management (ERM) program or other program which provides a structured, consistent and coordinated framework for assessing, responding to, and reporting on risks that affect the achievement of your organization's objectives? | N = 7 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Yes, and it is overseen by a Board committee                                                                                                                                                                                                                                           | 0     |
| Yes. Our Enterprise Risk Management (ERM) program is overseen by the Treasurer                                                                                                                                                                                                         | 1     |
| Yes, and it is overseen by the Executive Director                                                                                                                                                                                                                                      | 2     |
| No, we do not have an ERM program but we will be creating one soon                                                                                                                                                                                                                     | 1     |
| No, we do not have an ERM program and do not plan to have one                                                                                                                                                                                                                          | 3     |

| How is risk, including the risk of inaction, considered by the Board when deliberating major decisions? | N = 7 |
|---------------------------------------------------------------------------------------------------------|-------|
| Each major decision brought to the Board requires a formal risk assessment                              | 0     |
| A risk assessment is included when requested by the Board                                               | 1     |
| We do not utilize a formal risk assessment process in decision making by the Board                      | 6     |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Strategic Planning

- At most peer agencies the staff leads development of the strategic plan with varying degrees of involvement by the Board
- Most agencies update their strategies annually

| How does your organization develop a strategic plan?                        | N = 7 |
|-----------------------------------------------------------------------------|-------|
| Agency staff develops the strategy and the Board ratifies it                | 3     |
| Agency staff develops the strategy with input from the Board                | 1     |
| Agency staff and the Board work together to develop the strategy            | 2     |
| The Board develops the strategy with input from agency staff                | 0     |
| The Treasurer develops a strategic plan in collaboration with agency staff. | 1     |

| How frequently is the strategic plan: | Updated | Completely Renewed |
|---------------------------------------|---------|--------------------|
| Annually                              | 4       |                    |
| Every 2 years                         | 1       | 2                  |
| Every 3 years                         | 1       |                    |
| Every 4 years or more                 | 1       | 2                  |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Strategic Planning

- The Executive Director is most frequently leading development of the strategic plan

| Who among the agency staff is responsible for leading development of the strategic plan?                                                                                          | N = 7 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Chair of Board or Board Committee                                                                                                                                                 | 0     |
| Executive Director                                                                                                                                                                | 4     |
| Deputy ED or COO                                                                                                                                                                  | 1     |
| Head of Strategy                                                                                                                                                                  | 0     |
| The Treasurer and the Chief of Staff                                                                                                                                              | 1     |
| Comment: The Executive team is responsible for the Retirement Benefit Strategic Plan and the Retiree Healthcare Director is responsible for the Retiree Healthcare Strategic Plan |       |

## Appendix C: FAS Benchmarking Survey of PEBA Peers

### Business Resumption

- All of the peers have documented disaster recovery plans
- Most disaster recover plans and disaster drills appear to be staff driven
- Three of the peer agencies maintain a “hot” backup site

| Which of the following statements regarding business resumption apply to your organization:                  | N = 7 |
|--------------------------------------------------------------------------------------------------------------|-------|
| We have a fully documented disaster recovery plan                                                            | 7     |
| We maintain a “hot” backup site for business resumption                                                      | 3     |
| We have performed disaster drills to test our business resumption capabilities                               | 4     |
| We used outside consultants to assist in development of our business continuity plans                        | 1     |
| The Board has reviewed and is knowledgeable about our business continuity plans                              | 1     |
| Comment: The plan has evolved over twenty years of testing failures. Each year it keeps getting more robust. |       |

## Appendix D: Legal Compliance Requirements Applicable to PEBA's Plans

### Sample Federal Governmental Health Plan Compliance Items

#### 1. Applicable federal laws:

- Civil Rights Act (Title VII)
- Affordable Care Act (ACA)
  - Benefit Mandates
  - Employer Shared Responsibility
- Mental Health Parity and Addiction Equity Act (self-funded plans can elect to opt-out)
- Women's Health and Cancer Rights Act (self-funded plans can elect to opt-out)
- Newborns' and Mothers' Health Protection Act (self-funded plans can elect to opt-out)
- Family Medical Leave Act
- Uniformed Services Employment and Reemployment Act (USERRA)
- Age Discrimination in Employment Act
- Americans with Disabilities Act (ADA)
- Health Information Technology for Economic and Clinical Health Act (HITECH)
- Title VII of the Civil Rights Act and Pregnancy Discrimination Act
- Genetic Information Nondiscrimination Act – Employment Nondiscrimination Requirements
- Medicare Secondary Payer Requirements
- Medicare Part D (If prescription drug coverage is offered through the plan to Medicare Part D eligible individuals)
- HMO Nondiscrimination Requirement (if offer an HMO)
- TRICARE Requirements
- Public Health Service Act (PHSA)
- Health Insurance Portability and Accountability Act (HIPAA)
  - Portability
  - Administrative Simplification (Privacy and Security)
- Continuation Health Coverage (COBRA)
- Internal Revenue Code
  - Cafeteria plan?
  - Non-discrimination testing (self-funded only)

#### 2. Applicable state laws

- Article X, section 16, South Carolina Constitution
- Title 1, Chapter 11 of S.C. Code

## Appendix D: Legal Compliance Requirements Applicable to PEBA's Plans

### Sample Retirement Plan Compliance Items

1. Applicable federal laws:
  - Internal Revenue Code
    - Determination letters (as applicable)
    - Correction filings (as applicable)
  - Uniformed Services Employment and Reemployment Rights Act (USERRA)
  - Veterans Reemployment Rights Act (VRRRA)
  - Civil Rights Act (Title VII)
2. Applicable state laws
  - Article X, section 16, South Carolina Constitution
  - Title 9 of S.C. Code

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

**Funston Advisory Services' Response to the State Treasurer's Inquiries  
into Certain PEBA CAFR Footnote Disclosures**

**January 14, 2015**

## Appendix E: Inquiry Concerning Footnotes to the CAFR

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## Appendix E: Inquiry Concerning Footnotes to the CAFR

### Background:

Over the past three years, there have been multiple inquiries by the State of South Carolina's Treasurer and his staff (STO) regarding certain disclosures within the footnotes of the Public Employee Benefit Authority's (PEBA) audited Comprehensive Annual Financial Report (CAFR). These inquiries have generally focused on the integrity of the financial statements related to:

- 1) The appropriateness of footnote disclosures associated with Investment Commitments.
- 2) The completeness and accuracy of Commitment amounts disclosed within the financial statements.
- 3) The implications of *"additional commitments exist to underlying investments within strategic partnerships"*.

STO has expressed concern that these issues may have *"significant impact on our ability to issue state debt at terms most favorable to SC."* These inquiries have included various phone conversations and email correspondence between STO and PEBA's state appointed external audit firm CliftonLarsonAllen, LLP (CLA). Note: CliftonLarsonAllen has performed a comprehensive audit of PEBA's CAFR financial statements and disclosures (including footnotes) since PEBA's formation in 2012.

The role of the external financial auditor is to express an opinion over the client's financial statements (including relevant disclosures). In PEBA's case, the external auditor expressed an unqualified opinion over the financial statements in each year. This type of report is issued by an auditor when the financial statements presented are free of material misstatements and are represented fairly in accordance with the Generally Accepted Accounting Principles (GAAP). This means that the entity's financial condition, position, and operations are fairly presented in the financial statements.

An Unqualified Opinion indicates the following:

1. The Financial Statements have been prepared using the Generally Accepted Accounting Principles which have been consistently applied;
2. The Financial Statements comply with relevant statutory requirements and regulations;
3. There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements, where applicable;

## Appendix E: Inquiry Concerning Footnotes to the CAFR

4. Procedures have included evaluating information and account transactions provided by third parties (such as the RSIC) to reach their conclusion over PEBA's financial statements and disclosures taken as a whole;
5. Any changes in the accounting principles or in the method of their application and the effects thereof have been properly determined and disclosed in the Financial Statements.

Despite these unqualified opinions, the STO has continued to raise questions and, most recently, FAS received an inquiry from the State Treasurer's Office forwarded by the State Inspector General on Sunday, November 2, 2014. In that inquiry, STO raised questions about a Commitments spreadsheet prepared by RSIC which did not include the Lighthouse hedge fund. Because Lighthouse was not on the list, STO raised a concern that the reader would not *"suspect the amount committed would rise by almost \$5 billion dollars...certainly a material amount."* The Inspector General asked that we look into this matter as part of our fiduciary performance audit.

### Our Process of Review

We assessed PEBA's disclosures as follows:

- A comparison of PEBA disclosures and processes and compared them to the CAFR framework;
- Reviewed the correspondence between STO and CLA;
- Reviewed the June 30, 2013 PEBA CAFR Report emphasizing the Commitments footnote found on page 55 of the document;
- Reviewed the June 30, 2014 PEBA CAFR Report provided to us on November 24, 2014, emphasizing the Commitments footnote found on page 36;
- Reviewed the South Carolina Retirements Systems Investment Commission's Board Meeting Minutes from May 17-18, 2012 which references the approved capacity for the Lighthouse strategic partnership (page E-28); the minutes also helped obtain an enhanced understanding of the investment decision process and proposed changes to improve the level of transparency in financial disclosures;

## **Appendix E: Inquiry Concerning Footnotes to the CAFR**

- Reviewed the June 30, 2014 South Carolina Retirements System Investment Commission Commitments spreadsheet provided in an email message to Funston Advisory Services on Sunday, November 2, 2014;
- Compared the language used in PEBA's disclosure to six other similar state employee benefit systems;
- Compared the format and level of detail between PEBA's disclosures and those of the other systems;
- Held conference calls with the following individuals to obtain an understanding of the commitment disclosures and background:
  - Thomas Rey– CliftonLarsonAllen, Partner
  - Jon Rychener – RSIC, Director of Investment Reporting & Performance
  - Andrew Chernick – RSIC, Director of Operations and Operational Due Diligence
  - John Page – PEBA, Director of Internal Audit
  - Tammy Nichols – PEBA, Director of Retirement Systems Finance
  - Faith Wright – PEBA, Manager of Accounting

### **Summary Conclusions**

Based on the procedures performed above, Funston Advisory Services LLC concludes:

- 1) The footnote disclosures associated with Investment Commitments are appropriate and consistent with the requirements of a Comprehensive Annual Financial Report (CAFR) as required by the Government Accounting Standards Board and are consistent with Generally Accepted Accounting Principles (GAAP) and the disclosures of a sample of peer systems
- 2) The commitment amounts and fund manager types disclosed within the financial statements are appropriate. RSIC does not have outstanding unfunded capital commitments to hedge funds such as Lighthouse.
- 3) STO has identified a statement in the PEBA CAFR footnote which has an ambiguous reference to outstanding capital commitments and drawn an erroneous conclusion that further commitments exist beyond those stated in the CAFR. PEBA has acknowledged

## Appendix E: Inquiry Concerning Footnotes to the CAFR

the ambiguity and has revised the footnote for the FY2014 CAFR by including additional voluntary disclosures regarding approved funding levels for strategic partnerships and their current level of actual funding. It should be noted, however, that the FY2013 footnote met all reporting guideline requirements.

### Findings and Observations:

The following pages describe our analysis of findings and observations that led to these conclusions and includes:

- A. The legal and accounting framework for the proper presentation of CAFR information
- B. Benchmark examples of CAFR footnote disclosures by other systems

#### A. The Legal and Accounting Framework

##### CAFR Disclosure Requirements:

The financial reports of a state, municipal or other governmental entity must comply with the accounting requirements promulgated by the Governmental Accounting Standards Board (GASB). GASB provides standards for the content of a Comprehensive Annual Financial Report (CAFR) in its annually updated publication *Codification of Governmental Accounting and Financial Reporting Standards*.

A CAFR is "compiled" by a state, municipal or other governmental accounting staff and "audited" by an external American Institute of Certified Public Accountants (AICPA) certified accounting firm utilizing GASB requirements.

#### B. A Sample of Other System Disclosures

##### Commitment Footnote Disclosures:

The following discussion provides comparisons between PEBA's footnote disclosure of capital Commitments and those of six other state employee benefit systems.

##### PEBA's Commitments Disclosure Footnote:

*"The Investment Commission on behalf of the Systems, has entered into contractual agreements with numerous alternative investment managers and is*

## Appendix E: Inquiry Concerning Footnotes to the CAFR

*committed for future funding of private equity, real estate and opportunistic credit limited partnerships. As of June 30, 2013, the Systems had committed to fund various limited partnerships in the total amount of \$3.964 billion (U.S. dollars) and €277 million (Euros). The total unfunded commitment as of June 30, 2013, was \$1.173 billion (U. S. dollars) and €67 million (Euros). The total remaining commitment adjusted for cash flows as of September 19, 2013, is \$1.133 billion (U.S. dollars) and €58 million (Euros). Additional commitments exist to underlying investments within strategic partnerships. These underlying investments include hedge funds, private equity, real estate, opportunistic credit, short duration fixed income, commodities and high yield fixed income.”*

## Appendix E: Inquiry Concerning Footnotes to the CAFR

| System                                              | CAFR Footnote Disclosure                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|-----------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Wisconsin Department of Employee Trust Funds        | <p><b>10. Unfunded Capital Commitments (Pg. 37)</b></p> <p>The Core Fund has committed to fund various limited partnerships and side-by-side agreements related to its private equity and real estate holdings. Commitments that have not been funded total \$4.9 billion as of June 30, 2013. Unfunded commitments are not included in the financial statements since the amount and timing of the funding is not certain.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| Oregon Public Employees Retirement System           | <p><b>6. Unfunded Commitments (Pg. 45)</b></p> <p>OIC has entered into agreements that commit the Public Employees Retirement Fund (PERF), upon request, to make additional investment purchases up to a predetermined amount. As of June 30, 2013, the PERF had \$7,072.1 million in commitments to purchase private equity investments, \$2,214.0 million in commitments to purchase real estate investments, \$491.6 million in commitments to purchase alternative equity investments, and \$176.3 million in commitments to purchase opportunity portfolio investments, which includes \$79.8 million in recallable distributions. These amounts are unfunded and are not recorded in the Statement of Fiduciary Net Position.</p>                                                                                                                                                                    |
| North Dakota Public Employees Retirement System     | <p><b>NOTE 14 COMMITMENTS (Pg. 50)</b></p> <p>In 2007, the System entered into agreements with Sagitec Solutions, LLC and L.R. Wechsler, Ltd for the development of its new integrated benefits administration system. The contract with Sagitec is \$7.7 million and the contract with L.R. Wechsler is \$1 million, and the total appropriation for this project is approximately \$9.6 million, which was anticipated to be fully completed by June 2011. As of June 30, 2013, the System had paid \$8.6 million towards these contracts. The System delayed implementation of the member self-service functionality to 2012, therefore, the final payment was made to Sagitec during fiscal year 2013 upon completion of the warranty period.</p>                                                                                                                                                      |
| New Jersey Division of Pensions and Benefits        | <p><b>Commitments (Pg. 20)</b></p> <p>The Common Pension Funds are obligated, under certain private equity, real estate, real asset, and the absolute return strategy alternative investment and global diversified credit fund agreements to make additional capital contributions up to contractual levels over the investment period specified for each investment. As of June 30, 2013, the Common Pension Funds had unfunded commitments totaling approximately \$8.9 billion.</p>                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Los Angeles County Employees Retirement Association | <p><b>Capital Commitments</b> LACERA real estate, private equity, and activist investment managers identify and acquire investments on a discretionary basis. Each manager's investment activity is controlled by the LACERA Manager Investment Plan, which identifies the limitations on each manager's discretion. Such investment activities are further restricted by the amount of capital allocated or committed to each manager. Both the Manager Investment Plan and capital commitments are subject to approval by the BOI and may be updated as often as necessary to reflect LACERA investment preferences, as well as changes in market conditions.</p> <p>As of June 30, 2013, outstanding capital commitments to the various investment managers, as approved by the BOI, totaled \$3.02 billion. Subsequent to June 30, 2013, LACERA funded \$160 million of these capital commitments.</p> |
| State Employees' Retirement System of Illinois      | <p><b>Investment Commitments (Pg. 23)</b></p> <p>The ISBI's real estate and private equity investment portfolios consist of passive interests in limited partnerships. The ISBI had outstanding commitments to these limited partnerships of approximately \$278 million and \$478 million, as of June 30, 2013 and 2012, respectively. Also, at the end of fiscal year 2013 and 2012, the ISBI had outstanding commitments of \$7 million and \$196 million, respectively, to separate real estate accounts. Also at the end of fiscal year 2013 and 2012, the ISBI had outstanding amounts of \$60 million and \$63 million, respectively, committed to real assets. The ISBI would fund outstanding commitments by utilizing available cash and then selling liquid securities in the portfolio as necessary.</p>                                                                                       |

## Appendix E: Inquiry Concerning Footnotes to the CAFR

### Conclusion 1:

The footnote disclosures associated with Investment Commitments are appropriate and consistent with the requirements of Comprehensive Annual Financial Report (CAFR) as required by the Government Accounting Standards Board and are consistent with Generally Accepted Accounting Principles (GAAP) and the disclosures of a sample of peer systems.

### STO Inquiry #2:

*“Concerning the issue of SCRS Commitments as discussed in the notes on page 55 of the 2013 PEBA CAFR:*

*The notes reflect contractual commitments of \$3.964 billion for the date of June 30, 2013.*

*The attached RSIC spreadsheet is not complete as it omits information on certain investments and SP's such as, for example, the 3.2 billion dollar commitment to Lighthouse. The commitments detailed on this incomplete list are \$8.9 billion, for the date of June 30, 2014.*

*The last two sentences of the paragraph vaguely mention some commitments not detailed in the notes, but the note does not lead the reader to suspect the amount committed would rise by almost \$5 billion dollars...certainly a material amount.*

*This is but one area of the PEBA financials on which that the State Treasurer's Office needs clarification as it has significant impact on our ability to issue state debt at terms most favorable to SC.”*

### C. Findings and Observations:

One of the Investment Commissioners' roles and responsibilities is to identify and approve capacity allocations of investment funds to be implemented by RSIC investment staff. Once the Commission approves a capacity level for a particular investment, a contractual agreement is made between the limited partner investor (RISC) and the general partner, such as a real estate fund or private equity firm, which obligates the investor to contribute money to the fund, typically within a certain time frame. The investor may pay all of the committed capital at one

## Appendix E: Inquiry Concerning Footnotes to the CAFR

time, or make contributions over a period of time, often over a number of years. The difference between the contractually committed total investment and the amount actually contributed to-date is the unfunded capital commitment.

We were told by RSIC that among RSIC's investments there are only unfunded capital commitments for limited partnerships in private equity, private debt, and real estate. In the case of the hedge funds in which RSIC has invested, we were told that all allocated capital must be invested up front. Lighthouse (Investment Partners, LLC) is considered a hedge fund by RSIC and has no unfunded capital commitments from RSIC.

There could be instances where the investment Commission has approved investment capacity to a hedge fund which has not been utilized by the investment staff. In that particular case, the Commission's (RSIC's) approved funded capacity in excess of actual capital funded is not an unfunded capital commitment because any further funding is at the discretion of the investment staff and not a commitment. Even if there is an intention to fund further in the future, additional funding would be discretionary and not considered an unfunded capital commitment. Consequently, any investments made through Lighthouse are appropriately excluded from the "South Carolina Retirement Systems Investment Commitments" spreadsheet. Additionally, no other hedge funds are listed within the spreadsheet for the same reason.

### Conclusion 2:

**The commitment amounts and fund manager types disclosed within the financial statements are appropriate. RSIC does not have outstanding unfunded capital commitments to hedge funds such as Lighthouse.**

### STO Inquiry #3:

Related to the previous matter of Commitments, STO appears concerned that differences between what is disclosed in the PEBA financial footnote and the Commitment schedule provided by RSIC are due to inappropriate use of terminology in the audit opinion.

As described earlier, the CAFR footnote states "Additional commitments exist to underlying investments within strategic partnerships. These underlying investments

## Appendix E: Inquiry Concerning Footnotes to the CAFR

include hedge funds, private equity, real estate, opportunistic credit, short duration fixed income, commodities and high yield fixed income.”

This wording may be confusing to the reader as it implies that there are additional material fixed commitments that are not reflected in the RSIC Commitments worksheet. RSIC has explained that the outstanding commitments to investments within strategic partnerships are indeed reflected in the RSIC worksheet and have not been omitted.

Each strategic partnership has a maximum investment limit which has been approved by the RSIC commissioners. Although some of the funding levels are below the maximum approved level, any additional commitments will be at the discretion of RSIC. Both RSIC and PEBA indicate there were no additional material RSIC commitments to further fund any of the strategic partnerships. As a matter of practice, most new investments in the strategic partnerships today are being funded out of their allocation and existing liquidity.

### Findings and Observations:

STO appears to have assumed that the RSIC Commitment schedule did not include all investments because it excluded underlying investment commitments held inside strategic partnerships. Based upon the wording in the footnote, “Additional commitments exist to underlying investments within strategic partnerships,” this is not an unreasonable question. This misunderstanding gave rise to the concern that the terminology within the audit opinion was inappropriate.

Based upon the inquiries from STO, the CAFR for 2014 contains changes to the footnote to remove any ambiguity concerning Commitments. The changes include removing the statement about “additional commitments exist” as well as a schedule which lists each strategic partnership with its approved funding level and the current level of existing funding. These changes address the questions asked by STO and improve the clarity concerning RSIC’s outstanding Commitments which could generate future capital calls.

### Conclusion 3:

**STO has identified a statement in the PEBA CAFR footnote which has an ambiguous reference to outstanding capital commitments and drawn an erroneous conclusion that further commitments exist beyond those stated in the CAFR. PEBA has acknowledged the ambiguity and has prepared its FY2014 CAFR footnotes to convey the following additional, voluntary, disclosures:**

## **Appendix E: Inquiry Concerning Footnotes to the CAFR**

- **Clarifying the use of hedge fund and commodity investments within the Alternative Investments footnote. The clarifying language that was added specifically notes that “hedge fund and commodities investments are typically made on a subscription basis with a single, initial investment with no further commitment.”**
- **Clarified Alternative Investment Managers and Strategic Partner definitions.**
- **Incorporating an information table detailing strategic partnership investments. This table consists of Total Commitments, Amount Funded to Date and Remaining Unfunded Commitments by investment type in U.S. dollars and Euros.**

**PEBA’s Commitment footnote should be considered a leading practice based on FAS’ benchmarking analysis of other similar state employee benefit systems’ disclosures.**

## **Appendix E: Inquiry Concerning Footnotes to the CAFR**

### **Addenda to Appendix E:**

1. PEBA'S FY2013 Commitments Footnote
2. RSIC Meeting Minutes from May 17-18, 2012
3. FY2013 Unfunded Commitments
4. STO inquiry email

## Appendix E: Inquiry Concerning Footnotes to the CAFR

### Financial Section

At June 30, 2013, the Systems held swaps as shown in the table below (amounts expressed in thousands):

| Counterparty                       | Total Return Swaps    | SCRS Pays                 | SCRS Receives         | Maturity Date | Current Notional   | Gain (Loss) Since Trade |
|------------------------------------|-----------------------|---------------------------|-----------------------|---------------|--------------------|-------------------------|
| Bank of America Merrill Lynch      | DJ-UBS Commodities TR | 3 month T-Bill + 10 bps   | DJ-UBS Commodities TR | 8/30/2013     | \$ 221,518         | \$ (21,484)             |
| Bank of America Merrill Lynch      | DJ-UBS Commodities TR | 3 month T-Bill + 10 bps   | DJ-UBS Commodities TR | 2/28/2014     | 221,518            | (21,484)                |
| Credit Suisse                      | MSCI EM Proxy TR      | 3 Month US LIBOR + 25 bps | MSCI EM Proxy         | 10/29/2013    | 118,794            | (4,208)                 |
| Credit Suisse                      | MSCI EM Proxy TR      | 3 Month US LIBOR + 30 bps | MSCI EM Proxy         | 6/28/2013     |                    | (5,502)                 |
| Deutsche Bank                      | EAFE Proxy TR         | 3 Month US LIBOR - 23 bps | EAFE Proxy            | 8/30/2013     | 228,455            | 28,453                  |
| JP Morgan                          | EM Debt Proxy         | 3 Month US LIBOR + 55 bps | EM Debt Proxy         | 10/31/2013    | 92,124             | (7,878)                 |
| JP Morgan                          | EM Debt Proxy         | 3 Month US LIBOR + 55 bps | EM Debt Proxy         | 10/31/2013    | 91,554             | (8,448)                 |
| JP Morgan                          | EM Debt Proxy         | 3 Month US LIBOR + 55 bps | EM Debt Proxy         | 10/31/2013    | 91,522             | (8,478)                 |
| JP Morgan                          | EM Debt Proxy         | 3 Month US LIBOR + 60 bps | EM Debt Proxy         | 7/31/2013     | 90,582             | (9,418)                 |
| <b>Total Return Swap Exposures</b> |                       |                           |                       |               | <u>\$1,154,063</u> | <u>\$ (58,441)</u>      |

#### Alternative Investments

The Alternatives category includes exposure to private equity, global tactical asset allocation, absolute return, opportunistic credit, real estate, derivatives and strategic partnerships. Private equity investments are normally structured as limited partnerships. In this structure, the Systems is one of several limited partners, while the investment manager serves as the general partner. Investing in such limited partnerships legally obligates the Systems to invest the committed amount until the investment is fully funded or contractual investment period has expired. All other asset classes within the Alternatives category may be housed in a variety of legal structures. The Systems established several strategic partnerships to gain access to the best ideas of the investment manager, to receive favorable economics, and to efficiently take advantage of market opportunities. Investments within the strategic partnership accounts include allocations to private equity, opportunistic credit, real estate, absolute return strategies and cash. The Systems' allocation to opportunistic credit is designed to take advantage of the dislocations that have occurred in the credit markets. The Investment Commission's intent is to access superior risk-adjusted returns through a variety of different credit strategies.

#### Commitments

The Investment Commission on behalf of the Systems, has entered into contractual agreements with numerous alternative investment managers and is committed for future funding of private equity, real estate and opportunistic credit limited partnerships. As of June 30, 2013, the Systems had committed to fund various limited partnerships in the total amount of \$3.964 billion (U.S. dollars) and €277 million (Euros). The total unfunded commitment as of June 30, 2013, was \$1.173 billion (U. S. dollars) and €67 million (Euros). The total remaining commitment adjusted for cash flows as of September 19, 2013, is \$1.133 billion (U.S. dollars) and €58 million (Euros). Additional commitments exist to underlying investments within strategic partnerships. These underlying investments include hedge funds, private equity, real estate, opportunistic credit, short duration fixed income, commodities and high yield fixed income.

## **Appendix E: Inquiry Concerning Footnotes to the CAFR**

### **South Carolina Retirement System Investment Commission Meeting Minutes**

**May 17-18, 2012**

**Wampee Training and Conference Center  
1274 Wampee Plantation Road  
Pinopolis, South Carolina 29469**

#### **Commissioners Present:**

Mr. Allen Gillespie, Chairman  
Mr. Reynolds Williams, Vice Chairman (via Telephone)  
State Treasurer Curtis M. Loftis, Jr.  
Mr. Edward Giobbe  
Mr. James Powers  
Dr. Travis Pritchett

#### **Others present for all or a portion of the meeting on Thursday, May 17, 2012:**

Mike Addy, Geoff Berg, Jonathan Boyd, Betsy Burn, Sarah Corbett, Dori Ditty, Robert Feinstein, Rebecca Gunnlaugsson, Hershel Harper, Adam Jordan, David Klauka, Gary Li, Doug Lybrand, James Manning, Jared O'Connor, David Phillips, Kathy Rast, Eric Rovelli, Nancy Shealy, Nicole Waites, and Brian Wheeler, from the South Carolina Retirement System Investment Commission; Bill Leidinger, Bill Condon, and Shakun Tahiliani from the State Treasurer's Office; Bill Blume, Tammy Nichols, and Faith Wright from the South Carolina Retirement Systems; Rhett Humphreys and David Barnes from NEPC, LLC; Mel Carter, Lee Brashear, and Kelly Williams from Credit Suisse Asset Management, LLC; Sam Griswold and Wayne Pruitt from the SC State Retirees Association; Mitchell Willoughby from Willoughby and Hoefer; Mike Montgomery from Montgomery and Willard; and Alex Patrick from Creel Court Reporting.

#### **Others present for all or a portion of the meeting on Friday, May 18, 2012:**

Geoff Berg, Betsy Burn, Sarah Corbett, Robert Feinstein, Hershel Harper, Adam Jordan, David Klauka, Gary Li, James Manning, Jared O'Connor, David Phillips, Kathy Rast, Nancy Shealy, and Brian Wheeler, from the South Carolina Retirement System Investment Commission; Bill Leidinger, Bill Condon, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys and David Barnes from NEPC, LLC; Bill Blume, David Avant, and Tammy Nichols from the South Carolina Retirement Systems; Joe Newton from Gabriel, Roeder & Smith; Alan Bowser and Jeff Gardner from Bridgewater Associates; and Kelly Perkins, Sean McGould, and David Pollok from Lighthouse Partners.

### **I. CALL TO ORDER, CONSENT AGENDA, AND CHAIRMAN'S REPORT**

Chairman Allen Gillespie called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 9:30 a.m. Mr. Reynolds Williams participated in the meeting via telephone conference call. Chairman Gillespie referred to the proposed meeting agenda and asked for a motion to approve. Mr. James Powers made a motion, which was seconded by Mr. Edward Giobbe and passed unanimously, to approve the agenda as presented.

Chairman Gillespie began the Chairman's report. He asked Mr. Giobbe to provide an update of the Chief Investment Officer ("CIO") search from the work team, which was comprised of Messrs. Giobbe and Williams and Dr. Travis Pritchett. Mr. Giobbe stated that Ms. Joye Lang with the

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<sup>1</sup> Minutes from the May 17-18, 2012 Commission Meeting  
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## Appendix E: Inquiry Concerning Footnotes to the CAFR

South Carolina Office of Human Resources ("OHR") had provided a list of 32 applicants to the work team, which will review and recommend a list of the most qualified applicants to the Commission. Mr. Giobbe informed the Commission that they received a diverse pool of applicants from both the private sector and other state pension funds. Chairman Gillespie and Mr. Giobbe reiterated that the Commissioners were welcome to review all of the resumes and any additional information that was provided to the work team.

Chairman Gillespie provided an update from the Audit Committee and stated that the Audit Committee met and interviewed several candidates for positions within the internal audit and compliance areas. He said that the Audit Committee had extended an offer to one candidate who replied with a verbal acceptance, and they would hopefully receive a signed offer letter shortly. He noted that the Audit Committee was still in discussions with another candidate.

Chairman Gillespie announced that the Commission evaluation forms had been completed, and the primary items noted related to custody issues, the CIO search, and the review of current investment managers, investments, and associated fees.

### II. ADMINISTRATIVE ITEMS

Chairman Gillespie referred to the draft minutes from the March 23, 2012 meeting and asked for a motion to approve. In response to a question from Mr. Curtis Loftis, discussion ensued regarding the official Commission meeting minutes versus the unofficial transcripts and the process to amend minutes at subsequent meetings. Ms. Nancy Shealy, General Counsel, stated that the statute did not require a verbatim transcript for the minutes, only a summary of the discussions and actions. With regard to amending minutes after approval of the Commission, Ms. Shealy suggested that if there were inadvertent errors discovered after approval of the minutes, the Commission should address those issues at the next meeting. She explained that once the minutes are approved, they are considered the official, public record of the Commission with regard to the particular meeting. After further discussion about records retention, Ms. Shealy added that the unofficial transcripts and audio and video recordings were currently kept on file, but eventually, there could be storage space issues, and at this point, a protocol for storing or disposing of this information had not been determined by the Commission.

Dr. Pritchett made a motion, which was seconded by Mr. Powers and passed unanimously, to approve the minutes from the meeting on March 23, 2012.

Chairman Gillespie recognized Mr. Robert Feinstein, Chief Legal Officer, to present the draft Placement Agent Policy and the placement agent report. Mr. Feinstein provided background on the Placement Agent Policy, and stated that last year Commission staff ("Staff") began working on a placement agent disclosure policy. Mr. Feinstein stated also that earlier in the year, Mr. Loftis requested that Staff provide a list of all placement agents used by both strategic partners and in conjunction with alternative investments. Mr. Feinstein reiterated that the Commission did not hire placement agents; however, placement agents were retained by some investment managers to perform sales and marketing services. Mr. Feinstein advised that several members of Staff and the Commission's investment consultant, New England Pension Consultants, LLC ("NEPC"), worked together to canvas all of the investment management firms that had been engaged by the Commission since 2006. The result of the survey indicated that the vast majority of the managers did not use placement agents in conjunction with the Commission's investments.

Mr. Feinstein stated that it was not the intent of the Placement Agent Policy to proscribe the utilization of placement agents by investment managers; rather, the policy's purpose was to

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<sup>2</sup> Minutes from the May 17-18, 2012 Commission Meeting  
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## Appendix E: Inquiry Concerning Footnotes to the CAFR

provide the fiduciaries and stakeholders of the South Carolina Retirement Systems ("Retirement System") trust funds with additional information regarding the Commission's investment decision-making process. Mr. Feinstein added that Staff had determined that it was in the best interest of the Commission to require disclosure of the use of any placement agents.

Chairman Gillespie opined that the Placement Agent Policy should be modified for clarification purposes to include a placement and soliciting agent policy and to address the need for placement agents to be properly registered and follow the applicable securities laws regarding registration. Mr. Feinstein responded that Staff would welcome additional feedback from all of the Commissioners so that when it is presented at a future meeting, the policy would reflect the entire Commission's input. Chairman Gillespie advised the Commission that the Placement Agent Policy was presented as information for review and input from Commissioners and that no action was needed at this time.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit A).

Chairman Gillespie turned the discussion to the approval of the Compensation Policy amendments, which had been presented at the last Commission meeting. Mr. Powers made a motion, which was seconded by Dr. Pritchett and passed unanimously, to approve the Compensation Policy amendments as presented.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit B).

### III. ASSET ALLOCATION AND MANAGER SEARCHES

Mr. Hershel Harper, Acting Chief Investment Officer, stated that Staff was proposing the reclassification of investments with four managers, which would become effective on July 1, 2012, with the inception of the Fiscal Year 2012-2013 Annual Investment Plan. Mr. Harper stated that the reclassifications would provide a better alignment of how these managers actually manage assets and how the investments should be reflected from an asset allocation perspective. Mr. Harper added that Staff continued to work on improving transparency relating to the strategic partnerships and had developed certain new categorizations of the different investments, which led to the creation of some additional composites that better reflect the characteristics of these investments. Mr. Harper advised that Staff recommended approval of the proposed reclassification of the following: (1) Jamison, Eaton and Wood, Inc. ("Jamison"), from Core Fixed Income to Investment Grade Credit; (2) Torchlight Debt Opportunity Fund III, LLC and Torchlight Debt Opportunity Fund IV, LLC (collectively, "Torchlight") from Opportunistic Credit to Real Estate; (3) GS Mezzanine Partners V, L.P. ("GS Mezzanine") from Private Equity to Private Debt/Opportunistic Credit; and (4) Northstar Mezzanine Partners V L.P. ("Northstar") from Private Equity to Private Debt/Opportunistic Credit.

After further discussion, Mr. Giobbe made a motion, which was seconded by Mr. Powers and passed unanimously, to approve the proposed reclassification of the investments with Jamison, Torchlight, GS Mezzanine, and Northstar as proposed by Staff, and to authorize the Chairman to execute any necessary amendments, upon approval for legal sufficiency by the Commission's legal counsel ("Legal Counsel") to implement the Commission's actions.

Mr. Loftis stated that several members of the South Carolina State Senate had inquired about the Commission's involvement in the investments of the other post-employment benefits ("OPEB")

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trust funds that were managed by the State Treasurer's Office. He said that Senator Greg Ryberg indicated that a member of the Commission had suggested that the Commission become involved in the OPEB investments, and Senator David Thomas wanted to know the identity of the Commissioner. The Commissioners indicated that they were unaware of Mr. Loftis' inquiry. Mr. Powers said that he recalled that the Commission stayed away from the OPEB issues generally when the legislation passed several years ago. Mr. Williams said that the Commission had discussed several years ago when the OPEB trust funds were created that if certain constitutional amendments were made, then the Commission could manage the assets. Chairman Gillespie concurred and added that the Commission figured that it did not have any legislative authority to be involved with the OPEB investments, and he did not recall any discussions about the issues since that time.

Mr. Harper provided an overview of the asset class plan since the new asset allocation would become effective July 1, 2012, and reviewed a summary of the search activity anticipated during the new fiscal year as a result of the new asset allocation structure. Mr. Harper stated that Staff would be resuming the small to mid-cap manager search, locating a replacement candidate for an international equity manager because the proposed investment with Tradewinds Global Investors had been rescinded, conducting due diligence to potentially find another fixed income manager, adding an additional manager for emerging market debt investments, and lowering the allocation to global fixed income from three to one percent.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit C).

Mr. Harper reviewed the current asset allocation as of May 9, 2012, and the returns for March 2012. Mr. Harper stated that the total portfolio ("Portfolio") was up approximately 1.79 percent through March 2012 which was in line with the benchmark of 1.76 percent. April was a fairly flat month, and May had experienced significant volatility causing a decline of 2.5 percent. Fiscal year-to-date returns through mid-May were approximately negative 90 basis points, which was in line with the benchmark. Mr. Harper reported that hedge funds continued to perform well. GTAA multi-asset portfolios and risk parity were up 8 percent fiscal-year-to date, versus the benchmark of 1.30 percent. Bridgewater continued to be the top performer in this group, outperforming their benchmark by 1,200 basis points. Opportunistic credit returns were slightly negative for fiscal year-to-date. Mr. Harper stated that key areas in the Portfolio that Staff continued to watch closely would be in the emerging markets equity space, high yield managers, and private equity managers. Commissioners asked questions and discussed various aspects of the Portfolio throughout Mr. Harper's presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit D).

#### IV. INVESTMENT CONTRACT EXPIRATIONS

Mr. Harper advised the Commission that the investment management contracts with the following three managers would expire during the Summer of 2012: (1) Western Asset Management Company ("WAMCO"), in the global fixed income investment strategy; (2) TimesSquare Capital Management, LLC ("TimesSquare"), in the small-mid cap growth investment strategy; and (3) Grantham, Mayo, Van Otterloo & Co ("GMO"), in the global asset allocation investment strategy. Mr. Harper added that all managers were in good standing and Staff and NEPC recommended renewing these contracts.

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## Appendix E: Inquiry Concerning Footnotes to the CAFR

After further discussions about custody of the assets, contract termination provisions, and liquidity, Mr. Powers made a motion, which was seconded by Mr. Giobbe, to renew the contracts of WAMCO, TimesSquare, and GMO and to authorize the Chairman to execute the contracts upon approval for legal sufficiency by Legal Counsel. Further discussion ensued. Mr. Harper clarified for the Commission that TimesSquare investment was through a separately managed account structure and the assets were custodied at Bank of New York Mellon.

Mr. Powers amended his original motion, which was seconded by Mr. Giobbe, to renew the contracts with WAMCO and GMO and to authorize the Chairman to execute the contracts upon approval for legal sufficiency by Legal Counsel. The motion passed with Messrs. Giobbe, Powers, Williams, and Chairman Gillespie voting in favor of the motion, and Mr. Loftis voting against the motion due to custody of the funds not being with the Bank of New York Mellon.

Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed unanimously, to renew the contract with TimesSquare and to authorize the Chairman to execute the contract upon approval for legal sufficiency by Legal Counsel.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit E).

### V. SELENE II – FUND SIZE CLARIFICATION

Mr. Harper provided background information regarding the Selene Residential Mortgage Opportunity Fund I L.P., and Selene Residential Mortgage Opportunity Fund II L.P. ("Fund II"), and stated that these were direct investments by the Commission, separate and distinct from the R-SC Financing Conduit, LLC ("Ranieri") investment. Mr. Harper stated that Fund II fundraising had not been as successful as the general partner had hoped, and the Commission had a \$150 million commitment to this fund, which equated to approximately 32 percent of the total commitments by current investors in Fund II. Mr. Harper stated that he recommended that the Commission approve going beyond the 25 percent threshold for this particular type of investment. He advised the Commission that the initial approval of the investment was for up to \$150 million or 15 percent of Fund II; however, the 15 percent provision had not been included in the side letter. Mr. Harper reported that Fund II closed approximately one year after it was approved by the Commission, and the law firm of Amall Golden Gregory, LLP, had been engaged to lead the closing process on Fund II and Ranieri. Mr. Harper added that this closing occurred at about the same time that the investment in Ranieri closed, and he opined that the involvement of additional people, rather than a single point of contact, may have led to the omission of the provision.

After further discussion, Mr. Powers made a motion to waive the restriction in the Commission's Statement of Investment Objectives and Policies limiting the initial commitment to a fund to 25 percent of the total commitments raised by an external fund manager for the Selene Residential Mortgage Opportunity Fund II, with the caveat that this commitment could be used as leverage in negotiating investments in the larger relationship with investments in Ranieri. Mr. Giobbe seconded the motion, which passed unanimously.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit F).

## Appendix E: Inquiry Concerning Footnotes to the CAFR

### VI. RESERVOIR – CLARIFICATION OF COMMITMENT ALLOCATION

Mr. Harper reported that in June 2009, the Commission approved the formation of a strategic partnership with Reservoir Capital Group, LLC ("Reservoir"). The Commission initially approved an allocation of \$300 million committed capital to Reservoir/Palmetto State Partners, L.P. ("Reservoir-SP") which was to be allocated evenly to a private equity fund, a hedge fund seeding fund, and a co-investment focused fund. In September 2009, prior to the closing of the strategic partnership, the Commission committed \$100 million to the Reservoir Capital Partners (Cayman), L.P. ("RCP"), a private equity fund with a flexible investment mandate that allows for direct or indirect investments across the public and private markets. Reservoir-SP formally closed on June 1, 2011, and at that time the commitment to RCP was transferred into the Reservoir-SP. The Reservoir-SP Investment Committee then approved a \$100 million commitment to the Reservoir Strategic Partners Fund ("RSP"), a fund focused on hedge fund seeding. The third investment vehicle contemplated by the Commission's June 2009 decision has not yet been created within the Partnership.

Mr. Harper explained that on November 17, 2011, the Commission approved an increase of the Reservoir-SP capacity to an amount not to exceed \$750 million. The recommendation memo and supporting partnership annual investment plan that was presented to the Commission described the purpose of the additional capacity as focusing on opportunities in the power, energy, and investment seeding areas. However, a verbal response provided to a question posed during the presentation indicated that the increase in capital would be allocated such that Reservoir-SP would have \$100 million committed to RCP, \$100 million committed to RSP, and up to \$550 million committed to a "co-investment" vehicle.

Mr. Harper stated that following the November 2011 Commission meeting, work commenced on negotiating amendments to the Reservoir-SP limited partnership agreement ("LPA") to implement the Commission's approval of the increased capacity. During review of the proposed amendments, the Commission's General Counsel highlighted potential discrepancies between the language contained in the LPA, the language contained in the proposed amendments, and the scope of the Commission's approval. The Staff researched the issue and held several calls with Reservoir's staff to confirm the purpose of the additional capacity and how investments would be structured within Reservoir-SP. Mr. Harper added that discussions with Reservoir clarified that Reservoir-SP's capacity of \$750 million was intended to be allocated to new investments as opportunities arose and as approved unanimously by Reservoir-SP's Investment Committee. Reservoir-SP may allocate additional capital to (i) RCP, (ii) RSP, and/or (iii) other funds or co-investments within Reservoir's opportunity set (currently power, energy, and hedge fund seeding strategies).

The Commission discussed the history and various issues with Reservoir, including NEPC's position on the investment strategies. After further discussion, Mr. Powers made a motion to rescind the extension of the additional \$450 million commitment to Reservoir-SP so as to remain at the original \$300 million commitment. Mr. Giobbe seconded the motion. Further discussions ensued. Chairman Gillespie called the question of the motion to rescind the November 2011 motion for an additional \$450 million commitment to Reservoir-SP and to remain at the original \$300 million commitment. The motion passed with Messrs. Giobbe, Powers, Loftis, and Chairman Gillespie voting in favor of the motion, and Mr. Williams abstaining as he was not sure that he understood all of the issues discussed.

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Dr. Pritchett made a motion, which was seconded by Mr. Powers and passed unanimously, to grant Staff flexibility in determining how to allocate investments made with the \$100 million that had been approved by the Commission but not yet invested within Reservoir-SP.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit G).

Chairman Gillespie recessed the meeting for a break at 10:51 a.m. Mr. Williams, who had been participating in the meeting via telephone, left the meeting.

Chairman Gillespie reconvened the meeting at 11:02 a.m.

### **VII. INVESTMENT CONSULTANT RFP PROCESS DEFINITION**

Mr. Adam Jordan, Acting Chief Executive Officer, stated that at the April 18, 2012 meeting, the Commission voted to extend the current investment consultant contract and corresponding investment consultant proposals until September 30, 2012. Mr. Jordan added that as directed by the Commission previously, Staff had reviewed the proposals and conducted a preliminary assessment of the prospective investment consultants. He said that the Staff had been previously directed to provide information to the full Commission for the body to make a selection. Mr. Jordan requested that a Commissioner be appointed as a lead on the investment consultant Request for Proposal ("RFP") (similar to the current process for investment manager recommendations) to help pare down the proposals and conduct onsite due diligence trips with respondents. Mr. Jordan said that the lead Commissioner would work closely with Staff to narrow the field to a list of finalists, conduct due diligence trips on those finalists, and then make recommendations to the full Commission, at which time the full Commission would receive presentations from the finalists and make a selection of the investment consultant. He reiterated that all Commissioners would have full access to the proposals during the selection process.

Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed, to appoint Mr. Loftis and Dr. Pritchett to work with Staff on selecting a short list of candidates for the investment consultant search to be reviewed by the entire Commission. Chairman Gillespie and Messrs. Giobbe, Loftis and Powers voted in favor of the motion, and Mr. Williams was not present for the vote.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit H).

Mr. Williams re-joined the meeting via telephone conference call at 11:13 a.m.

### **VIII. DISCUSSION OF TIME-WEIGHTED RETURNS VS. DOLLAR-WEIGHTED RETURNS**

Mr. Harper introduced the next item on the agenda and explained that the Commission had requested that Staff and/or NEPC provide an educational presentation regarding time-weighted returns versus dollar-weighted returns. He said that particularly in evaluating the success of managers of private equity and private debt investments, the outcome could differ significantly depending on the calculations used.

Mr. Harper introduced Mr. Rhett Humphreys, Partner and Senior Consultant with NEPC. Mr. Humphreys reviewed the definitions of time-weighted and dollar-weighted returns and provided examples of when each should be used as performance measurements. He explained that time-weighted return is also known as compound return, which eliminated the impact of cash flows

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during the time periods and allows managers to be measured on how well they performed independently and in comparison to benchmarks. Mr. Humphreys stated that internal rate of return is also known as dollar-weighted return, which is used with private equity managers because the manager controls the cash flow for the investments. The dollar-weighted return measures the growth of an average amount of dollars invested over the evaluation period. Mr. Humphreys provided examples and responded to questions by the Commission.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit I).

### **IX. AVENUE-SC GLOBAL OPPORTUNITIES FUND, L.P. – PERFORMANCE REVIEW**

Mr. Harper introduced Mr. Dave Klauka, Director of Private Markets, to discuss the Avenue-SC Global Opportunities Fund, L.P. ("Avenue"). It was noted that at the Commission's April 2012 meeting, Mr. Powers had requested a review of this fund/manager.

Prior to beginning his presentation, Mr. Klauka introduced and welcomed the newest staff member to the private markets team, Mr. Eric Rovelli, Senior Real Estate Officer. Mr. Klauka stated that for the past 11 years, Mr. Rovelli served as the primary real estate point of contact for the Arizona State Retirement System.

Mr. Klauka referred to materials that had been provided to the Commission and discussed the structure of the Avenue partnership, which is essentially a master fund established for the Retirement System that invests in distressed debt funds managed by Avenue Capital in the United States and Europe. He discussed performance of Avenue as of December 31, 2011, noting that the Avenue Europe I fund had performed exceptionally well with a gross internal rate of return ("IRR") of 23 percent, and a net IRR of 17.5 percent. Mr. Klauka added that Avenue had invested \$167 million of this fund, and they had returned \$164 million to its investors, so essentially all of the investors had received their contributions back and there was still another \$80 million of unrealized value in the fund. Mr. Klauka stated that the Avenue Special Situations Fund VI was still in the investment period and had made no distributions back to the investors. Avenue had invested about \$1.5 billion of the Special Situations Fund VI. This fund had negative returns for the fourth quarter of 2011, which decreased the value of the investments that they were currently holding to approximately \$1.4 billion. Mr. Klauka added that currently, the fund had a negative IRR because of market volatility, but many of those losses were unrealized and had been recovered during the first quarter of 2012. Mr. Klauka answered questions about the Avenue investments and concluded his presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit J).

### **X. SOUTH CAROLINA PRIVATE EQUITY**

Mr. Harper provided background information regarding the past efforts of the Commission to establish an in-state private equity program, and then he introduced Ms. Kelly Williams, Managing Director and Group Head of the Customized Fund Investment Group ("CFIG") of Credit Suisse Asset Management, LLC ("Credit Suisse") to present an approach for a geographically focused private equity program. Mr. Harper advised the Commission that the Staff had not conducted a manager search process and was not recommending any approvals at this time. Mr. Harper noted that Credit Suisse manages a number of in-state programs for other states, including North Carolina and Florida.

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Ms. Williams introduced her colleagues, Mr. Mel Carter, Principal, and Mr. Lee Brashear, Vice President, and provided a summary of CFG's proposal for a South Carolina private equity fund. Ms. Williams stated that the proposed strategy would include equity co-investments of 60 percent to 80 percent, growth capital fund investments of up to 20 percent, and mezzanine investments through the creation of a Small Business Investment Company ("SBIC") of up to 20 percent. The fund would seek to achieve competitive risk-adjusted returns while supporting the economic well-being of South Carolina.

Ms. Williams provided an overview of CFG and stated that they were one of the largest fund investors in the world, managing approximately \$28 billion of capital for institutional investors. CFG focuses on helping investors tailor portfolios to their individual needs, and they have an experienced team of 120 professionals globally. Ms. Williams advised that CFG manages approximately \$1.5 billion of regionally targeted programs, including North Carolina, Florida, Indiana, Oregon, New York, and Michigan.

Mr. Brashear provided an overview of the Florida Opportunity Fund, which is a \$29.5 million regional private equity program that makes targeted investments in seed and early stage venture capital funds.

Dr. Pritchett opined that the Commission should focus on returns, not just seeking economic development within the state. Ms. Williams agreed and stated that the fund would be customized for South Carolina, and CFG would collaborate with the Commission on how the branding would be communicated to attract the right types of proposals.

Ms. Williams described the private equity programs developed for New York, Indiana, and Michigan. Mr. Brashear followed this discussion with an overview of the North Carolina Innovation Fund and then described CFG's projections for opportunities in South Carolina. Mr. Brashear stated that South Carolina had a great tax regime for incentives as well as low corporate tax rates and a very pro-business environment. He pointed out that South Carolina also offers a great infrastructure for supporting all types of businesses with the Charleston Port, and South Carolina is a major manufacturing state. He said South Carolina's major business sectors include aerospace, automotive, biotechnology and pharmaceuticals, distribution, food processing, forestry and wood products, and plastics and chemicals. Mr. Brashear advised the Commission that South Carolina ranks 33rd in the nation for dollars invested into the state. Over the last ten years, the majority of private equity investments in South Carolina had been in industrial and energy, retailing and distribution, software, and electronics. Mr. Brashear added that the private equity capital invested in South Carolina over the last ten years was allocated to buyout at 70.4 percent, venture capital at 27.9 percent, and mezzanine at 1.7 percent.

Mr. Carter provided funding details of a proposed South Carolina Opportunity Fund and stated that there were three different opportunities for growth, including equity co-investments, growth capital fund investments, and mezzanine investments through the creation of a regionally-targeted SBIC. He stated that the South Carolina Opportunity Fund would provide the further diversification of the Retirement System's private equity portfolio and would help bridge the funding gap for South Carolina-based growth companies. Mr. Carter discussed the key aspects of building a regionally-targeted fund, including community outreach, sourcing of opportunities, and customization to meet the Commission's specifications.

Following further discussion, Mr. Harper thanked Ms. Williams and her team for their presentation and educating the Commission on CFG's private equity proposal. Mr. Harper

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reiterated that this proposal was not a Staff recommendation, but rather educational information about in-state private equity programs.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit K).

### **XI. CUSTODIAN RFP UPDATE**

Mr. Jordan provided the Custodian RFP update and stated that the State Treasurer's Office ("STO"), the South Carolina Retirement Systems ("SCRS"), and the Commission entered into a contract with Callan Associates ("Callan") to assist with the Custodian RFP and search process in August of 2011. The cost of the contract with Callan was shared three ways, and Callan had helped to evaluate the proposals received from custodian candidates. Mr. Jordan advised that after a thorough evaluation process, including onsite visits, the evaluation panel (which included representatives from the Commission, the SCRS, and the STO) would reconvene on May 22<sup>nd</sup> to make decisions on securities lending, custody, and ancillary services, and thereafter make their recommendations to the State Treasurer. Mr. Jordan advised the key decisions that needed to be made by the Commission included: (1) whether the Commission would engage in securities lending, and if so, with whom; (2) if the Commission engaged in securities lending, then what would be the investment guidelines for that portfolio; (3) where would the revenues be booked; (4) would the Commission contract for ancillary services, and if so, which services; (5) how the costs would be paid; and (6) how the contract would be structured.

Mr. Jordan turned the floor over to Mr. Harper to discuss securities lending. Mr. Harper provided an historical recap about the experience of the securities lending program and explained the mechanics of securities lending in general. Mr. Harper stated that currently the estimated revenue generated from the securities lending pool would total approximately \$1.3 million dollars. This amount, split 85 percent to the Retirement System trust and 15 percent to Bank of New York Mellon, is extremely low compared to historic levels. Mr. Harper opined that securities lending had a poor risk/return trade-off because of the amount of securities that had to be on loan to generate income.

Responding to a question from Mr. Giobbe, Mr. Harper opined that he would not recommend pursuing securities lending, but pointed out that a key factor was deciding who should be the contracting party for securities lending -- whether the contract should stay with the State Treasurer or whether the Commission would take responsibility for contracting for securities lending. Mr. Harper explained that currently, the securities lending program was wrapped on a bundled basis with the custodian, the Bank of New York Mellon. In 1996, all of the Retirement System's assets were still managed by the STO. It was not until 1999-2000 that assets started being managed outside of the STO. Mr. Harper advised the Commission that the contract for custody and securities lending had never been unbundled.

Mr. Bill Leidinger, Chief of Staff of the STO, opined that at this stage of the procurement, the Commission might not have sufficient information to make a decision on the securities lending program. Mr. Harper disagreed, and stated that what needed to be decided was who should be contracting for securities lending and ancillary services on behalf of the Commission. Mr. Harper opined that because securities lending was an investment decision, it should be the decision of the Commission, as should the ancillary services that support the Commission.

Chairman Gillespie recognized Dr. Rebecca Gunnlaugsson, Systems and Economic Specialist. Dr. Gunnlaugsson described ancillary services as all the system services which were used to

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manage the investments in the trust fund. The categories that the systems fall under include: performance and attribution; analytics and risk management; support for private investments, transparency, and administration of hedge funds; and data management. Dr. Gunnlaugsson provided a background of why ancillary services within the scope of the custody RFP were being discussed and other options by which these services could be retained, including going to a third-party administrator or building out each one of the components independently. She advised that both of these latter options would have a large cost and require multiple RFP processes, which would be time consuming.

Mr. Jordan advised the Commission that Staff's recommendation was that the Commission affirm that it is the only entity which could determine whether the trust fund would participate in a securities lending program, determine what services were required by the Commission to properly invest and manage the Retirement System's Portfolio, and to enter into those contracts in the near term. Mr. Jordan added that in the future, Staff would come back to the Commission with recommendations on the securities lending program, the services that Staff recommended be obtained through the custody bank or elsewhere, and any budget impacts that those recommendations might have.

Mr. Loftis voiced his concern about the timeliness of the information being posted to the extranet and said he would have liked to have reviewed this information prior to attending the meeting. Mr. Loftis opined that this was another example of lack of transparency and accountability. He stated that he could not discuss what he wanted to talk about because of the onerous confidentiality agreements that the Commission had in place. Dr. Pritchett stated that he had not seen the information until today himself, and he did not know when it was posted to the extranet. Mr. Jordan explained that he would have liked to have had a presentation on the extranet earlier; Staff had worked diligently to have the information ready to post, and external legal counsel for the lawsuit against the Bank of New York Mellon had to confirm that they were comfortable with certain language in the document. Chairman Gillespie commented that the Commission has been consistent for the last two or three years in its request to have the information posted to the extranet at a minimum of one week in advance. Chairman Gillespie stated that if this continued to be an issue, the item would have to be pulled and posted to the next Commission meeting agenda.

In response to a question from Mr. Loftis, Mr. Jordan introduced the external legal counsel, Mr. Mitchell Willoughby from Willoughby and Hoefer, and Mr. Mike Montgomery from Montgomery and Willard.

Mr. Jordan pointed out these issues were first outlined in a letter dated December 1, 2011, from the Chairman to Mr. Loftis in which Chairman Gillespie discussed these issues of contracting and engaging in securities lending. The latest communication from Mr. Loftis indicated that there may not be another opportunity to bring this information back to the Commission to make a decision; therefore, Staff felt it was necessary to bring these issues to the Commission's attention as it is the entity that invests and manages the assets of the Retirement System. Mr. Loftis reiterated that he did not know that this topic was going to be included on the agenda, and he referred to earlier discussions about management of the OPEB trust funds and questioned the communication between Staff and Commissioners regarding securities lending and ancillary services for the Commission.

Mr. Harper advised that he and Dr. Gunnlaugsson had met with Mr. Loftis a few weeks ago in the Commission's offices, and one of the issues discussed was who would contract for these

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services. Mr. Harper said that Mr. Loftis responded that he had not been involved with some of the details, but he asked Mr. Leidinger to follow up. Mr. Leidinger stated that the State Treasurer would not enter into a contract for securities lending and ancillary services without first bringing it to the Commission. Several hours after that conversation, Mr. Leidinger sent an email that said there may not be an additional opportunity for the Commission to address this issue. As a result, Mr. Harper stated that he sent an email to all Commissioners to make them aware of the change. Mr. Harper reiterated that for purposes of this agenda item, the primary concern was with the securities lending program and ancillary services for the Commission.

Further discussion ensued. Mr. Loftis raised concerns about proper notice of agenda items and confidentiality issues. He said that he was unable to discuss certain items due to confidentiality issues, stating that he had talked to probably hundreds of people about the confidentiality issues and he could not find anyone with contracting like the Commission's provisions. Mr. Powers stated that everyone was entitled to their opinion and perhaps it was time to start putting all of the facts on the table in front of a mediator or getting lawyers involved, because the issues were not getting resolved. Mr. Giobbe agreed that another objective opinion would be helpful, and these issues should not impede the Commission's mission, which is to invest and manage the assets of the Retirement System.

After further discussion, Chairman Gillespie stated that he would like to see the Commission make a commitment to hire the STO as a fixed income manager, have the Commission decide the portfolios and parameters, and let the State Treasurer decide if he wants to hire a sub-advisor to manage this portion of the securities lending program.

Following further discussion, Mr. Powers made a motion to contract with the State Treasurer's Office, pursuant to the Commission's statutory authority, to perform securities lending duties and to acquire ancillary services in accordance with any specifications determined appropriate by the Commission. Dr. Pritchett seconded the motion. Further discussion ensued to clarify the differences between securities lending and ancillary services, and the motion passed unanimously.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit L).

### **XII. UPDATE REGARDING INFORMATION ACCESS AND CONFIDENTIALITY DISCUSSIONS WITH STO**

Mr. Feinstein provided an update regarding information access and confidentiality discussions with the STO. He stated that at the April 2012 Commission meeting, Staff was directed to continue discussions with the STO to determine their requirements regarding sharing information necessary to properly discharge the State Treasurer's duties with regard to the Retirement System and to report back to the Chairman. Mr. Feinstein advised that Staff attempted to implement the directive, and there had been an exchange of letters between Staff and the STO. A meeting took place on May 14, 2012, involving representatives of the Commission, STO, and SCRS, but these various communications had not yielded any resolution with regard to information access and the core custody functions that needed to be performed. Mr. Feinstein stated that the STO continued to take the position that it would not approve the initial funding of any new investments approved by the Commission after April 17, 2012, unless the State Treasurer or his office was provided all information that the STO deemed necessary. Mr. Feinstein advised that Staff was not able to obtain clarification from the STO as to the exact information that the STO required in order to approve the initial funding of new investments. Mr.

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Feinstein stated that this was a basic core custody function, and the STO had been asked on numerous occasions to provide new forms or revisions to existing forms that set forth information needed to open an account and proceed with the funding of a new investment.

Mr. Feinstein reminded the Commission that there were four investments approved at the April 2012 Commission meeting which were presently slated to go to closing at the end of May and would thereafter be presented to the STO for funding. The four investments included: (1) Kildonan Castle Partners; (2) Highbridge Quantitative Commodities Fund; (3) Blackstone Real Estate Partners VII, L.P. ("Blackstone"); and (4) Sankaty Credit Opportunities Fund V, L.P. ("Sankaty"). Mr. Feinstein advised that after the Commission goes to closing on Blackstone and Sankaty, the Retirement System would be contractually obligated to fund the entire commitment amount that was approved by the Commission at the April meeting. He noted further that in the case of Blackstone, the manager would be presenting the initial capital call at or just after closing. If the initial capital call was not honored, it would constitute a default on the initial capital call, which would cause immediate and serious consequences, both in terms of monetary penalties and reputational harm to a number of entities, not limited to the RSIC. Mr. Feinstein advised the Commission that Staff and counsel were obligated to move forward with the process of finalizing and preparing to close on the investments that the Commission had approved, unless directed otherwise by the Commission.

Responding to a question by Mr. Giobbe, Mr. Feinstein clarified that the investment contracts had not been signed, but noted that if the Chairman did not execute the contracts, effectively he would be vetoing what the Commission had approved.

Mr. Loftis opined that the Commission was asking him to send money out of the State's control without any information on where it goes, and as a fiduciary and custodian, he had a right to look over the contracts. Mr. Loftis also opined that the Commission was deciding for him what his fiduciary responsibilities are, and he was only receiving the information that the Commission wanted him to have.

Responding to a question from Mr. Loftis, Ms. Shealy clarified that Staff was bound to confidentiality by statute. She pointed out that the statutes specifically apply to Commissioners and Commission staff, whereas employees of other agencies were not referenced in those statutes.

Mr. Feinstein asked Mr. Loftis if the STO would be willing to revise the existing set of custodial forms to show what additional or different information he would require to provide approval for initial funding. Mr. Loftis replied that he was prepared to let a court settle everything. Mr. Loftis opined that the custodian's interest may not always be aligned with the Commission, and stated that he did not work for the Commission, was not the custodian for the Commission, and he was not supposed to be in alignment with the Commission.

At this point, Mr. Loftis asked if the Commission could go into executive session. Mr. Feinstein stated that the Commission could recede to executive session for the purpose of receiving legal advice.

### XIII. EXECUTIVE SESSION

Mr. Powers made a motion to recede to executive session. Mr. Loftis seconded the motion, which passed unanimously, and Chairman Gillespie announced that the Commission would meet

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in executive session to discuss matters relating to personnel recruiting, receipt of legal advice and discussion of proposed contractual matters, receipt of a legal briefing relating to pending litigation and discussion of investment matters pursuant to S.C. Code Ann. §§ 9-16-80 and 9-16-320.

Chairman Gillespie thanked the guests in attendance, and the Commission recessed into executive session at 2:36 p.m. The Commission reconvened in open session at 6:11 p.m., and Chairman Gillespie stated that while in executive session, the commission took no reportable action, but they discussed legal issues relating to confidential information, reviewed and discussed information relating to strategic partnership investments, and received a legal briefing on pending litigation involving the Bank of New York Mellon.

The meeting recessed at 6:12 p.m., to reconvene at 8:30 a.m. on Friday, May 18, 2012.

#### **XIV. CALL TO ORDER, REGULAR COMMISSION BUSINESS MEETING**

Chairman Gillespie reconvened the meeting at 8:30 a.m. on Friday, May 18, 2012. It was noted that Mr. Williams was unable to attend due to a scheduling conflict.

#### **XV. LIGHTHOUSE PLATFORM & PARTNERSHIP REVIEW**

Mr. Harper introduced Sean McGould, CEO/CIO, Kelly Perkins, Co-CIO, and David Pollok, Legal Counsel, from Lighthouse Partners. Mr. Harper stated that the Lighthouse Palmetto Strategic Partnership ("Lighthouse-SP") was a very important strategic partnership for the Commission, and it was one of the largest at \$3.5 billion in total capacity. Mr. Harper provided a brief background of the hedge fund transition which began in 2009 and described the rationale behind the transition from Fund of Funds Hedge Funds to Direct Hedge Funds, as well as the key benefits and challenges of transitioning to Direct Hedge Funds.

Mr. Harper recognized Mr. David Phillips, Senior Alternatives Officer, who provided an overview of the benefits and advantages of managed accounts. Mr. Phillips then recognized Mr. McGould who provided a brief background of Lighthouse Partners ("Lighthouse") and summarized what the firm was doing with regards to managed accounts. Mr. McGould stated that Lighthouse was formally established and began accepting assets from external investors in 1999. Gradually, ownership transferred from SunTrust Banks, Inc. to the management of Lighthouse.

Mr. McGould outlined key control and protection benefits of managed accounts. He said that asset ownership helped to mitigate the risk of fraud. Asset segregation reduced influences of external investors, and there was an increased ability to revoke an investment manager's trading authority. There were no holdbacks or suspensions at the underlying manager level, and investment managers traded the portfolio subject to agreed-upon guidelines. He noted further the benefits of independent valuation, administration and audit; and diversification of counterparty risk.

Mr. McGould discussed the transparency of managed accounts and stated that managed accounts provided daily position-level exposure and enhanced risk analysis; more data to support investment decisions; and the ability to detect and address style drift, correlation and concentration.

Mr. McGould reviewed the cumulative estimated daily performance of the Lighthouse-SP versus traditional benchmarks.

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Responding to a question regarding custodial issues, Mr. Pollok discussed the custodial aspects of Lighthouse and stated that Lighthouse worked with approximately 10 primary custodians currently.

Following additional questions and discussion, Mr. Harper thanked Lighthouse for their presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit M).

### XVI. BRIDGEWATER – RISK OVERVIEW

Mr. Harper introduced Mr. Alan Bowser and Mr. Jeff Gardner from Bridgewater Associates ("Bridgewater"). Mr. Gardner provide information related to Bridgewater's market analysis, their views on the investment-related risk of running a pension fund, and how they would address some of those risks. Mr. Gardner explained the definition of deleveraging and stated that a deleveraging occurs when debt and debt service payments become too high relative to the cash flows needed to service them. Deleveraging could be well managed or badly managed, and the differences in outcomes depended largely on the amount and pace of austerity, defaults, transfers, and money printing.

Mr. Gardner discussed passive versus active market risk. He stated that the traditional portfolio was productive in the past, but the majority of the returns came from cash. However, with cash rates near zero, the traditional approach would not meet the target returns. Mr. Gardner added that risk was multi-dimensional, and protecting against risk involved many different layers and different kinds of risk controls. He stressed that risk controls were not a separate function; they had to be built into the overall investment discipline. He opined that the best way to mitigate risk and raise returns was by diversification.

Mr. Gardner stated that alpha could be extremely valuable to a portfolio by providing a high potential for return and allowing for diversification; however, there was no guarantee of a positive return because alpha was driven by manager skill.

Following additional questions and discussion, Mr. Harper thanked Bridgewater for their presentation.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit N).

### XVII. ACTUARIAL UPDATE

Mr. Joe Newton from Gabriel, Roeder & Smith, provided an actuarial update. Mr. Newton stated that there were three factors that affect pension plans: contributions, benefits, and investments. He discussed the results of an experience study of the Retirement System conducted in 2011, and highlighted significant changes that had been made as a result of the study, including decreasing the investment rate of return from 8 percent to 7.50 percent.

Mr. Newton also reviewed the 2011 valuation results for the South Carolina Retirement System, including the actuarial accrued liability, the unfunded actuarial accrued liability ("UAAL"), the current funding ratio, current contribution rate, and the 30 year employer contribution rate. Additionally, he explained how lowering the current investment return from 7.5 percent to 7.0 percent would impact UAAL, the funding ratio, and 30-year employer contribution rate.

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Mr. Newton discussed the historical UAAL growth for the South Carolina Retirement System, funding ratios, and the estimated yields based on market value of assets from 2002 to 2011. Mr. Newton concluded his discussion by stating that future ad hoc benefit enhancements and overall payroll growth were the largest non-investment related risk.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit O).

### **XVIII. RETIREMENT SYSTEMS UPDATE**

Mr. Jordan introduced Mr. Bill Blume, Director, and Mr. David Avant, Managing Legal Counsel, from the South Carolina Retirement Systems.

Mr. Avant provided an overview and update on the Retirement System. He discussed the importance of investments to the overall income of the trusts and reviewed the five defined benefit plans that make up the South Carolina Retirement Systems, including the South Carolina Retirement System; the Police Officers Retirement System; the Retirement System for Members of the General Assembly; the Retirement System for Judges and Solicitors; and the National Guard Retirement System. Mr. Avant reported on the total active and inactive members of all systems, the total number of annuitants, total covered payroll, and total number of employers within all of the plans. Mr. Avant also reviewed the average benefit for all annuitants, the benefits formula, eligibility, and the actuarial accrued liability of the South Carolina Retirement System and the Police Officers Retirement System.

Mr. Avant concluded his discussion by providing a summary of pending legislation related to the Retirement Systems that was being considered by the legislature.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit P).

Chairman Gillespie stated that he received a request from Legal Counsel for a motion related to the confidentiality issues and sharing of information with the STO. Mr. Powers made a motion to obtain external fiduciary counsel to review issues relating to confidentiality and disclosure matters. Mr. Giobbe seconded the motion, which passed unanimously.

### **XIX. ADJOURNMENT**

There being no further business, Chairman Gillespie thanked everyone for attending. Mr. Giobbe made a motion to adjourn, which was seconded by Mr. Powers and passed unanimously, and the meeting adjourned at 12:31 p.m.

Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance and in the lobby at 1201 Main Street, Columbia, SC, and at the Wampee Training and Conference Center at 1274 Wampee Plantation Road, Pinopolis, South Carolina prior to 9:00 a.m. on May 14, 2012.]

## Appendix E: Inquiry Concerning Footnotes to the CAFR

**South Carolina Retirement Systems Investment Commitments  
For FY Ended June 30, 2014**

| <u>Asset Class</u>    | <u>Manager Ref</u> | <u>Total<br/>Commitment as<br/>of 6/30/14</u> | <u>Capital Applied<br/>to Commitment</u> | <u>Unfunded<br/>Commitment</u> |
|-----------------------|--------------------|-----------------------------------------------|------------------------------------------|--------------------------------|
| <b>Private Equity</b> |                    |                                               |                                          |                                |
| Private Equity        | Fund Manager 1     | 45,000,000                                    | 18,180,000                               | 26,820,000                     |
| Private Equity        | Fund Manager 2     | 66,102,500                                    | 15,236,418                               | 50,866,082                     |
| Private Equity        | Fund Manager 3     | 172,924,901                                   | 172,924,901                              | -                              |
| Private Equity        | Fund Manager 4     | 100,000,000                                   | 100,000,000                              | -                              |
| Private Equity        | Fund Manager 5     | 100,000,000                                   | 63,811,098                               | 36,188,902                     |
| Private Equity        | Fund Manager 6     | 100,000,000                                   | 100,000,000                              | -                              |
| Private Equity        | Fund Manager 7     | 16,500,000                                    | 13,749,140                               | 2,750,860                      |
| Private Equity        | Fund Manager 8     | 30,000,000                                    | 23,113,741                               | 6,886,259                      |
| Private Equity        | Fund Manager 9     | 30,000,000                                    | 10,358,847                               | 19,641,153                     |
| Private Equity        | Fund Manager 10    | 100,000,000                                   | 80,536,652                               | 19,463,348                     |
| Private Equity        | Fund Manager 11    | 100,000,000                                   | 84,622,111                               | 15,377,889                     |
| Private Equity        | Fund Manager 12    | 40,000,000                                    | 12,027,424                               | 27,972,576                     |
| Private Equity        | Fund Manager 13    | 40,000,000                                    | 38,000,000                               | 2,000,000                      |
| Private Equity        | Fund Manager 14    | 40,000,000                                    | 34,000,000                               | 6,000,000                      |
| Private Equity        | Fund Manager 15    | 40,000,000                                    | 4,800,000                                | 35,200,000                     |
| Private Equity        | Fund Manager 16    | 100,000,000                                   | 72,012,529                               | 27,987,471                     |
| Private Equity        | Fund Manager 17    | 50,000,000                                    | 40,723,457                               | 9,276,543                      |
| Private Equity        | Fund Manager 18    | 50,000,000                                    | 40,783,744                               | 9,216,256                      |
| Private Equity        | Fund Manager 19    | 125,000,000                                   | 101,875,000                              | 23,125,000                     |
| Private Equity        | Fund Manager 20    | 100,000,000                                   | 65,976,485                               | 34,023,515                     |
| Private Equity        | Fund Manager 21    | 99,800,000                                    | 99,800,000                               | -                              |
| Private Equity        | Fund Manager 22    | 37,960,000                                    | 32,266,000                               | 5,694,000                      |
| Private Equity        | Fund Manager 23    | 40,000,000                                    | 31,709,022                               | 8,290,978                      |
| Private Equity        | Fund Manager 24    | 50,000,000                                    | 38,206,918                               | 11,793,082                     |
| Private Equity        | Fund Manager 25    | 50,000,000                                    | 39,000,000                               | 11,000,000                     |
| Private Equity        | Fund Manager 26    | 100,000,000                                   | 100,000,000                              | -                              |
| Private Equity        | Fund Manager 27    | 50,000,000                                    | 22,125,000                               | 27,875,000                     |
| Private Equity        | Fund Manager 28    | 50,000,000                                    | 43,352,408                               | 6,647,592                      |
| Private Equity-SP     | Fund Manager 29    | 79,881,957                                    | 79,881,957                               | -                              |
| Private Equity-SP     | Fund Manager 30    | 80,000,000                                    | 3,534,105                                | 76,465,895                     |
| Private Equity-SP     | Fund Manager 31    | 98,814,229                                    | 98,814,229                               | -                              |
| Private Equity-SP     | Fund Manager 32    | 25,722,700                                    | 25,722,700                               | -                              |
| Private Equity-SP     | Fund Manager 33    | 148,221,300                                   | 56,865,219                               | 91,356,081                     |
| Private Equity-SP     | Fund Manager 34    | 116,773,125                                   | 90,808,062                               | 25,965,063                     |
| Private Equity-SP     | Fund Manager 35    | 46,880,000                                    | 46,880,000                               | -                              |
| Private Equity-SP     | Fund Manager 36    | 140,625,000                                   | 100,945,160                              | 39,679,840                     |
| Private Equity-SP     | Fund Manager 37    | 150,000,000                                   | 105,724,894                              | 44,275,106                     |
| Private Equity-SP     | Fund Manager 38    | 19,217,250                                    | 19,217,250                               | -                              |
| Private Equity-SP     | Fund Manager 39    | 30,000,000                                    | 27,035,974                               | 2,964,026                      |
| Private Equity-SP     | Fund Manager 40    | 10,000,000                                    | 10,000,000                               | -                              |
| Private Equity-SP     | Fund Manager 41    | 99,795,030                                    | 70,642,415                               | 29,152,615                     |
| Private Equity-SP     | Fund Manager 42    | 99,795,030                                    | 72,454,251                               | 27,340,779                     |
| Private Equity-SP     | Fund Manager 43    | 99,795,030                                    | 86,257,413                               | 13,537,617                     |
| Private Equity-SP     | Fund Manager 44    | 20,000,000                                    | 20,000,000                               | -                              |
| Private Equity-SP     | Fund Manager 45    | 75,000,000                                    | 26,877,859                               | 48,122,141                     |
| Private Equity-SP     | Fund Manager 46    | 15,000,000                                    | 15,000,000                               | -                              |
| Private Equity-SP     | Fund Manager 47    | 14,850,000                                    | 14,850,000                               | -                              |
| Private Equity-SP     | Fund Manager 48    | 102,092,736                                   | 102,092,736                              | -                              |
| Private Equity-SP     | Fund Manager 49    | 95,079,000                                    | 95,079,000                               | -                              |
| Private Equity-SP     | Fund Manager 50    | 21,331,220                                    | 21,331,220                               | -                              |
| Private Equity-SP     | Fund Manager 51    | 85,180,013                                    | 85,180,013                               | -                              |
| Private Equity-SP     | Fund Manager 52    | 49,500,000                                    | 18,626,866                               | 30,873,134                     |

## Appendix E: Inquiry Concerning Footnotes to the CAFR

|                                                |                  |                      |                      |                    |
|------------------------------------------------|------------------|----------------------|----------------------|--------------------|
| Private Equity-SP                              | Fund Manager 53  | 200,000,000          | 148,814,396          | 51,185,604         |
| <b>Total Private Equity</b>                    |                  | <b>3,846,841,021</b> | <b>2,941,826,613</b> | <b>905,014,408</b> |
| <b>Private Debt/Opportunistic Credit</b>       |                  |                      |                      |                    |
| Private Debt                                   | Fund Manager 54  | 40,000,000           | 40,000,000           | -                  |
| Private Debt                                   | Fund Manager 55  | 100,000,000          | 100,000,000          | -                  |
| Private Debt                                   | Fund Manager 56  | 75,000,000           | 65,046,729           | 9,953,271          |
| Private Debt                                   | Fund Manager 57  | 100,000,000          | 91,188,262           | 8,811,738          |
| Private Debt                                   | Fund Manager 58  | 100,000,000          | 35,749,269           | 64,250,731         |
| Private Debt                                   | Fund Manager 59  | 100,000,000          | 100,000,000          | -                  |
| Private Debt                                   | Fund Manager 60  | 100,000,000          | 59,104,104           | 40,895,896         |
| Private Debt                                   | Fund Manager 61  | 100,000,000          | 26,100,000           | 73,900,000         |
| Private Debt                                   | Fund Manager 62  | 50,000,000           | 43,157,996           | 6,842,004          |
| Private Debt                                   | Fund Manager 63  | 190,000,000          | 190,000,000          | -                  |
| Private Debt                                   | Fund Manager 64  | 50,000,000           | 23,500,000           | 26,500,000         |
| Private Debt                                   | Fund Manager 65  | 141,817,986          | 141,817,986          | -                  |
| Private Debt                                   | Fund Manager 66  | 150,000,000          | 71,066,553           | 78,933,447         |
| Private Debt                                   | Fund Manager 67  | 50,000,000           | 12,860,219           | 37,139,781         |
| Private Debt                                   | Fund Manager 68  | 100,000,000          | 84,255,306           | 15,744,694         |
| Private Debt                                   | Fund Manager 69  | 141,701,505          | 117,674,760          | 24,026,746         |
| Private Debt                                   | Fund Manager 70  | 18,411,590           | 18,411,590           | -                  |
| Private Debt                                   | Fund Manager 71  | 212,450,600          | 212,450,600          | -                  |
| Private Debt                                   | Fund Manager 72  | 197,628,458          | 197,628,458          | -                  |
| Private Debt                                   | Fund Manager 73  | 74,110,672           | 41,110,452           | 33,000,220         |
| Private Debt                                   | Fund Manager 74  | 96,000,000           | 96,000,000           | -                  |
| Private Debt                                   | Fund Manager 75  | 368,000,000          | 368,000,000          | -                  |
| Private Debt                                   | Fund Manager 76  | 24,750,000           | 19,936,521           | 4,813,479          |
| Private Debt                                   | Fund Manager 77  | 39,600,000           | 39,600,000           | -                  |
| Private Debt                                   | Fund Manager 78  | 99,000,000           | 26,605,358           | 72,394,642         |
| Private Debt                                   | Fund Manager 79  | 420,750,000          | 379,676,880          | 41,073,120         |
| Private Debt                                   | Fund Manager 80  | 99,000,000           | 2,096,609            | 96,903,391         |
| Private Debt                                   | Fund Manager 81  | 50,000,000           | 44,935,130           | 5,064,870          |
| Private Debt                                   | Fund Manager 82  | 99,795,030           | 78,595,928           | 21,199,102         |
| <b>Total Private Debt/Opportunistic Credit</b> |                  | <b>3,388,015,841</b> | <b>2,726,568,710</b> | <b>661,447,131</b> |
| <b>Real Estate</b>                             |                  |                      |                      |                    |
| Real Estate                                    | Fund Manager 83  | 135,000,000          | 84,752,153           | 50,247,847         |
| Real Estate                                    | Fund Manager 84  | 75,000,000           | 55,418,149           | 19,581,851         |
| Real Estate                                    | Fund Manager 85  | 75,000,000           | 35,251,522           | 39,748,478         |
| Real Estate                                    | Fund Manager 86  | 100,000,000          | 55,003,985           | 44,996,015         |
| Real Estate                                    | Fund Manager 87  | 150,000,000          | 136,873,493          | 13,126,507         |
| Real Estate                                    | Fund Manager 88  | 50,000,000           | 41,573,053           | 8,426,947          |
| Real Estate                                    | Fund Manager 89  | 75,000,000           | 60,000,000           | 15,000,000         |
| Real Estate                                    | Fund Manager 90  | 75,000,000           | 52,500,000           | 22,500,000         |
| Real Estate                                    | Fund Manager 91  | 70,000,000           | 49,516,451           | 20,483,549         |
| Real Estate                                    | Fund Manager 92  | 99,460,195           | 68,834,813           | 30,625,382         |
| Real Estate                                    | Fund Manager 93  | 75,000,000           | 48,750,000           | 26,250,000         |
| Real Estate                                    | Fund Manager 94  | 100,000,000          | 100,000,000          | -                  |
| Real Estate                                    | Fund Manager 95  | 75,000,000           | 52,500,000           | 22,500,000         |
| Real Estate                                    | Fund Manager 96  | 98,814,229           | 58,020,469           | 40,793,760         |
| Real Estate                                    | Fund Manager 97  | 24,703,557           | 16,638,522           | 8,065,035          |
| Real Estate                                    | Fund Manager 98  | 80,300,000           | 80,300,000           | -                  |
| Real Estate                                    | Fund Manager 99  | 92,167,400           | 72,700,076           | 19,467,324         |
| Real Estate                                    | Fund Manager 100 | 98,395,400           | 86,445,751           | 11,949,649         |
| Real Estate                                    | Fund Manager 101 | 75,000,000           | 75,000,000           | -                  |
| Real Estate                                    | Fund Manager 102 | 7,798,776            | 5,888,004            | 1,910,772          |
| Real Estate                                    | Fund Manager 103 | 74,250,000           | 28,270,733           | 45,979,267         |
| <b>Total Real Estate</b>                       |                  | <b>1,705,889,557</b> | <b>1,264,237,174</b> | <b>441,652,383</b> |

## Appendix E: Inquiry Concerning Footnotes to the CAFR

**From:** "Loftis, Curtis" <[Curtis.Loftis@sto.sc.gov](mailto:Curtis.Loftis@sto.sc.gov)>  
**Date:** November 1, 2014 at 10:47:32 AM EDT  
**To:** "Adams, Clarissa" <[Clarissa.Adams@sto.sc.gov](mailto:Clarissa.Adams@sto.sc.gov)>, "Lamkin, Brian" <[BrianLamkin@oig.sc.gov](mailto:BrianLamkin@oig.sc.gov)>  
**Cc:** "Harmon, Rick" <[Rick.Harmon@sto.sc.gov](mailto:Rick.Harmon@sto.sc.gov)>  
**Subject:** PEBA Commitments.

Hi Brian and Clarissa,

Concerning the issue of SCRS Commitments as discussed in the notes on page 55 of the 2013 PEBA CAFR:

The notes reflect contractual commitments of \$3.964 billion for the date of June 30, 2013.

The attached RSIC spreadsheet is not complete as it omits information on certain investments and SP's such as, for example, the 3.2 billion dollar commitment to Lighthouse. The commitments detailed on this incomplete list are \$8.9 billion, for the date of June 30, 2014.

The last two sentences of the paragraph vaguely mention some commitments not detailed in the notes, but the note does not lead the reader to suspect the amount committed would rise by almost \$5 billion dollars...certainly a material amount.

This is but one area of the PEBA financials on which that the State Treasurer's Office needs clarification as it has significant impact on our ability to issue state debt at terms most favorable to SC.

Respectfully,

Curt Loftis.

Curtis M. Loftis, Jr.  
State Treasurer of South Carolina

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## **Appendix G: List of Interviews**

### **Internal interviews:**

- All PEBA Board members
- Executive Director
- Chief Operating Officer
- Director of Retirement Systems Finance
- Investment Accounting Manager
- Defined Contribution Unit Manager
- Director of Employee Insurance Program Finance
- Employee Insurance Program Controller
- Employee Insurance Quality Assurance Manager
- General Counsel
- Director of Administration
- Director of Customer Services
- Call Center Manager
- Customer Intake and Field Education Manager
- Claims Processing Managers
- Service Purchase/Audit Manager
- Communications Manager
- Internal Audit Manager
- Manager of Governmental Affairs
- Manager of Research, Wellness Strategy and Prevention Partners
- Prevention Partners Manager
- Manager of Human Resources
- Manager of Information Technology

### **External interviews:**

- Actuary - Insurance
- Actuary - Retirement
- External Financial Auditor – Retirement System
- External Financial Auditor – Insurance Programs
- External Financial Auditor – Defined Contribution Programs
- Prescription Benefits Manager
- Health Insurance Claims Administrator

## **Appendix G: List of Interviews**

- Long-Term Disability Insurance Carrier
- Recordkeeper/Administrator for DC Plans
- ORP - Investment Consultant
- DC - Investment Consultant
- Executive Director of the Retirement System Investment Commission
- Retirement and Pre-Retirement Advisory Panel Chair
- State Retirees Association Board Members
- South Carolina Education Association Executive Director
- Palmetto State Teachers Association Executive Director
- South Carolina State Employees Association Executive Director
- South Carolina Sheriffs' Association Executive Director
- South Carolina Law Enforcement Association Executive Director
- Senate Finance Committee Chief of Staff
- Former Senate Finance Committee Member
- Large Retirement Plan Employer
- Small Retirement Plan Employer
- Large Insurance Plan Employer
- Small Insurance Plan Employer

## Appendix H: List of Documents Reviewed

- SCRS CAFR FYE 06/30/2013
- SCRS CAFR FYE 06/30/2012
- SCRS CAFR FYE 06/30/2011
- Insurance Benefits Audited Financial Statements FYE 06/30/2013
- Employee Insurance Program Audited Financial Statements FYE 06/30/2012
- Employee Insurance Program Audited Financial Statements FYE 06/30/2011
- Retiree Health Insurance Trust Fund Audited Financial Statements FYE 06/30/2013
- Retiree Health Insurance Trust Fund Audited Financial Statements FYE 06/30/2012
- Retiree Health Insurance Trust Fund Audited Financial Statements FYE 06/30/2011
- Long-Term Disability Insurance Trust Fund Audited Financial Statements FYE 06/30/2013
- Long-Term Disability Insurance Trust Fund Audited Financial Statements FYE 06/30/2012
- Long-Term Disability Insurance Trust Fund Audited Financial Statements FYE 06/30/2011
- 401(k) Plan Financial Statement Report FINAL 12- 31-2013
- 401(k) Plan Financial Statement Report FINAL 12- 31-2012
- 401(k) Plan Financial Statement Report FINAL 12- 31-2011
- 457 Plan Financial Statement Report FINAL 12- 31-2013
- 457 Plan Financial Statement Report FINAL 12- 31-2012
- 457 Plan Financial Statement Report FINAL 12- 31-2011
- SCRS Handbook
- PORS Handbook
- JSRS Info from Website
- GARS Info from Website
- NGRS Guide
- Deferred Compensation Plans
- Optional Retirement Program
- Insurance Benefits Guide
- IFS Final Report 10-21-2008 Confidential
- 2014 Legislative Update External
- 2013 Legislative Update
- Retirement Benefits Website - Legislative Update Info
- 2013 SCRS Actuarial Valuation Report
- 2013 PORS Actuarial Valuation Report
- 2013 GARS Actuarial Valuation Report
- 2013 JSRS Actuarial Valuation Report
- 2013 NGRS Actuarial Valuation Report
- 2013 OPEB Actuarial Valuation Report
- Examples of Reported Incidents and Responses
- SC PEBA IT Risk Assessment by Deloitte 08-30- 2013 CONFIDENTIAL
- SC PEBA IT Vulnerability Assessment by Deloitte 08-30-2013 CONFIDENTIAL
- Internal Audit Report On Operational Reports 08- 28-2014 (Page5/6)
- IT status reports
- FY\_2013-14 Performance Measurements DATA REQ

## Appendix H: List of Documents Reviewed

- Internal Audit Report on Data Security 05-30- 2014
- Internal Audit Report on Data Security 05-30- 2014
- SCRS and PORS 2011 Actuarial Experience Study
- Ethics and the Rules of Conduct for SC State Employees 2013
- Governors Executive Order to Study SC Rules of Conduct 2014
- SC PEBA Board Ethics and Conflicts of Interest Policy
- Ethics Commission Website and Filings
- Organizational Risk Assessment Memo, Policy, and Prior Reports
- Memo - PEBA Compliance with State and Federal Law 09-26-2014
- Fraud Risk Assessment Results 2010
- Memo re Anti-Fraud Measures 09-28-2014
- MOU RSIC PEBA Jan 2014
- Bruner, Powell, Wall & Mullins, LLC
- Ice Miller LLP Budget & Control Board Minutes
- Ice Miller LLP Ltr of Engagement Sept 2006 DB plan
- Ice Miller LLP Ltr of Engagement Sept 2008 DB plan signed
- Ice Miller LLP Ltr of Engagement Sept 2008 Deferred Comp
- Poyner Spruill
- Sowell Gray Stepp and Laffitte Budget & Control Board Minutes
- Sowell Gray Stepp and Laffitte LLC
- 2010 Evidence-Based Medicine Promotion RFP
- 2010 Evidence-Based Medicine Promotion RFP - Amendment 1
- 2010 Evidence-Based Medicine Promotion RFP - Amendment 2
- 2011 DC Inv Consultant RFP Final with Attachments
- 2011 Dental RFP - April 29, 2011
- 2011 Dental RFP - April 29, 2011 Amendment #1
- 2012 Flexible Benefits Plan RFP 2-10
- "2012 Flexible Benefits Plan RFP 2-10 Amendment #1"
- "2012 Flexible Benefits Plan RFP 2-10 Amendment #2"
- 2013 Fiduciary Liability Insurance RFP
- 2013 NEW PBM RFP
- 2013 NEW PBM RFP - Amendment #1
- 2013 NEW PBM RFP - Amendment #2
- 2013 NEW PBM RFP - Amendment #3
- 2014 Recordkeeper RFP - Deferred Compensation
- 2014 Recordkeeper RFP - Deferred Compensation - Amendment Number One (1)
- 2014 Recordkeeper RFP - Deferred Compensation - Amendment Number Two (2)
- FY2015 Contract with GRS 06-12-2014
- Great West Service Agreement and Amendments
- Bylaws signed by Board 9.18.13
- PEBA Strategic Plan 2013-2014
- Accountability Report FY 2013-14

## Appendix H: List of Documents Reviewed

- SCRS Strategic Plan - Previous Version 2010- 2014
- EIP Strategic Plan - Previous Version - 2012 Update
- Deferred Comp Strategic Plan 2010- 2014
- Communications Matrix 20140530
- PEBA (Visio) org charts as of 09/02/2014 with names and job titles; no headcounts; Updated 09/29/2014
- Boykin - PD and Bio
- Van Camp - PD
- Corbett - PD
- Nichols - PD and Bio
- Buie - PD and Bio
- Graham - PD and Bio
- Phipps - PD and Bio
- Lightle - PD
- Smoak - PD
- Burgis - PD and Bio
- Bynoe - PD
- Oliver - PD
- Brown - PD and Bio
- Page - PD and Bio
- Vacancies 9-2014
- Compensation Practices
- Memo and Graphs Relating to PEBA Employee Survey
- HR's Workforce Plan and Grid 2014
- HR Training - Examples
- HIPAA Privacy, Info Sec, and Emergency Preparedness Training - Sign In Sheets 2014
- Training and Travel for 2012 (Latest Available)
- SCRS Disaster Recovery Plan and Post Test Report 2012
- EIP 2009 Disaster Recovery Test Report from DSIT - IAD Review 05-16-2013
- Disaster Recovery Procedures
- Applicable state laws governing PEBA
- State ORP Plan Document - 11.20.13
- ORP Investment Policy Statement - 06.19.13
- 401(k) Plan Document - 09.27.13
- 457 Plan Document - 09.27.13
- DC Plan Investment Policy Statement - 09.27.13
- State\_Health\_Plan\_2014
- MUSC Health Plan Final 2014
- Memo re SCRS Plan Document 09-24- 2014
- Cafeteria Plan 2014
- Memo to Funston re Organizational Policies and Procedures with Examples 09-26-2014
- Research and Statistics - Policies, Procedures, and Governing Documents - Redaction Not Needed
- PEBA HR Policies
- Retirement - Actuarial Funding and Valuation Policies - From CAFR
- Insurance - Actuarial Funding and Valuation Policies
- Retirement - Actuarial Funding and Valuation Policies - From CAFR
- Insurance - Actuarial Funding and Valuation Policies
- Pension Audit and Funding Disclosure 2014

## Appendix H: List of Documents Reviewed

- PEBA Audit Policy
- Compensation Practices
- State HR Regulations - includes Classified Employee Pay Plan
- SC PEBA Procurement Policies and Regulations with Links to SC BCB
- SC PEBA News Media and FOIA Requests Policies and Procedures 20140709
- SC PEBA Social Media Policy FINAL 20140709
- E-Mail Signature Line Disclaimer 20140909
- SC Title 30-4 Freedom of Information Act
- Organizational Risk Assessment Memo, Policy, and Prior Reports
- Memo re Whistleblower Hotline 09-24-2014
- Customer Service Policy - From the Strategic Plan 2013-2014
- PEBA Board Education Policy Approved 10.16.13
- Travel and Reimbursement Policy - Board Approved 9.18.13
- SC PEBA Security Manual 09-30-2014
- SC PEBA Privacy Manual 09-30-2014
- Data Classification Policy
- Data Integrity Policy
- Memo to FAS Regarding Data Warehouse 09-25- 2014
- Memo to FAS Regarding Physical Security 09-25- 2014
- User Request Process
- Production Change Tracking
- Third Party Software-Vendor Log Reviewed by Internal Audit 05-02-2014
- Business Continuity Memo and Scope of Work
- PEBA Section of Act 278 of 2012
- Bylaws signed by Board 9.18.13
- FAAC Committee Charter APPROVED by Board 7.16.14
- Health Policy Charter Approved by PEBA Board 7.16.14
- Retirement Policy Committee Charter Approved by PEBA Board 7.16.14 signed copy
- Ethics and the Rules of Conduct for SC State Employees 2013
- Governors Executive Order to Study SC Rules of Conduct 2014
- SC PEBA Board Ethics and Conflicts of Interest Policy
- Ethics Commission Website and Filings
- Board Presentation - Overview of Ethics Act
- PEBA Section of Act 278 of 2012 Governing Laws FINAL
- Fiduciary Duties and Liability FINAL
- PEBA Division of Responsibilities
- 2011 FOIA Guide to Compliance
- Introduction to Roberts Rules of Order
- PEBA Board Education Policy Approved 10.16.13
- Board Appointee and Qualifications
- Creation of Committees and Authority from Bylaws
- FAAC Committee Charter APPROVED by Board 7.16.14 - Signed Copy

## Appendix H: List of Documents Reviewed

- Health Policy Charter Approved by PEBA Board 7.16.14 - Signed Copy
- Retirement Policy Committee Charter Approved by PEBA Board 7.16.14 signed copy
- Board Presentation - Overview of Ethics Act
- State Ethics Commission Reminder
- Statement of Economic Interest Filing Instructions 2012
- Statement of Economic Interest Filing Instructions 2013
- PEBA Board Conflicts of Interest Policy Approved 6.18.14
- PEBA Board Meeting Minutes
- PEBA Board Presentations
- Attendance Record 2012, 2013, 2014
- Fiduciary Duties and Liability FINAL
- Attendance Record 2012, 2013, 2014
- Board Presentation - Overview of Ethics Act
- SC PEBA Board Ethics and Conflicts of Interest Policy
- Fiduciary Liability Insurance - Primary RLI 2014
- Fiduciary Liability Insurance - Excess Hudson 2014
- Fidelity Bond Policy 2013
- Agency Head Evaluations Ltr from Senate Finance
- Agency Head Evaluation Statutes
- Agency Head Evaluation Survey Form
- Chairman's cover letter for 2014 evaluations
- Article 12 SHP Plan of Benefits - Claims and Appeals Procedure
- Article 12 MUSC Plan of Benefits - Claims and Appeals Procedure
- South Carolina Retirement Systems Claims Procedure 2005
- Retirement - Employer Manual 2015
- Insurance - BA Manual 2014
- Insurance Procedures
- Memo to FAS Regarding Policies and Procedures
- Benefit Statement Policies and Practices
- Internal Controls - Memo, Write-Ups, and Examples
- Retirement Benefits Website - News and Updates
- Retirement Benefits Website - Publications
- Retirement Benefits Website - Videos
- CEM - Defined Benefit Administration Benchmarking Analysis
- Call Center Surveys Jan 1 - December 31 2013
- Call Center Surveys YTD 2014
- Customer Service - Visitor Center Quality Check Results FY 2014
- EMail and Paper Surveys for PEBA FY 2014
- Call Center Surveys Jan 1 - December 31 2013
- Call Center Surveys YTD 2014
- Customer Service - Visitor Center Quality Check Results FY 2014
- EMail and Paper Surveys for PEBA FY 2014

## Appendix H: List of Documents Reviewed

- CEM - Defined Benefit Administration Benchmarking Analysis
- Accountability Report FY 2013-14
- 2010 Evidence-Based Medicine Promotion RFP
- 2010 Evidence-Based Medicine Promotion RFP - Amendment 1
- 2010 Evidence-Based Medicine Promotion RFP - Amendment 2
- 2011 Dental RFP - April 29, 2011
- 2011 Dental RFP - April 29, 2011 Amendment #1
- 2012 Flexible Benefits Plan RFP 2-10
- 2012 Flexible Benefits Plan RFP 2-10 - Amendment 1
- 2012 Flexible Benefits Plan RFP 2-10 - Amendment 2
- 2013 NEW PBM RFP (5.13.2013)
- 2013 NEW PBM RFP - Amendment 1
- 2013 NEW PBM RFP - Amendment 2
- 2013 NEW PBM RFP - Amendment 3
- 2011 DC Inv Consultant RFP Final with Attachments
- Insurance Benefits Guide
- Insurance Benefits Website - News and Updates
- Retirement Benefits Website - News and Updates
- Insurance Advantage Newsletter - Employee Edition - 2013
- Insurance Advantage Newsletter - Employee Edition - 2014
- Insurance Advantage Newsletter - Retiree Edition - 2013
- SCRS Handbook
- PORS Handbook
- JSRS Info from Website
- GARS Info from Website
- NGRS Guide
- Deferred Compensation Plans
- Optional Retirement Program
- Select Your Retirement Plan
- Insurance Benefits Guide
- When you Become Eligible for Medicare
- SCRS Handbook
- PORS Handbook
- JSRS Info from Website
- GARS Info from Website
- NGRS Guide
- Deferred Compensation Plans
- Optional Retirement Program
- Select Your Retirement Plan
- Insurance Benefits Guide
- When you Become Eligible for Medicare
- Insurance Benefits Website - Publications
- Select Your Retirement Plan - Trifold
- Your Plan at a Glance - SCRS
- Your Plan at a Glance - PORS
- TERI Program Overview
- Retirement Benefits Website - Are You Ready
- Understanding Your Retirement Plan Presentation
- Retirement Benefits Website - Calculators
- Insurance - Benefits Administrator Manual 2014
- Insurance - Benefits Administrator Weekly News From Website

## Appendix H: List of Documents Reviewed

- Insurance - Benefits Administrator News All - From Website
- Insurance - More Benefits Administrator News - From Website
- Retirement - Electronic Employer Systems (EES Portal) News, Videos, Etc.
- Retirement - Employer Manual
- Retirement - Employer Training Dates
- Retirement - Employer Training Modules
- Benefits at Work Conference Presentations
- Insurance Presentations Website Links
- Insurance - Open Enrollment Presentation 2014
- Example Member Statements - Redacted
- Communications Matrix 20130605 - REV 20140530
- Retirement Benefits Website - Publications Archives 09-18-2014
- Insurance Benefits Website - Publications List
- Memo re Communications to Key Stakeholders
- SCPEBA News Media and FOIA Requests Policy and Procedures FINAL 20140709
- SCPEBA Social Media Policy FINAL 20140709
- Memo re Communications Training Program
- Internal Controls - Memo, Write-Ups, and Examples
- Retirement QA Process and Procedures Manual - Redacted
- Sample of Insurance QA Procedures
- Memo to FAAC regarding IAD QA 11-25-2013
- IAD QAIP Procedures
- Organizational Risk Assessment Memo, Policy, and Prior Reports
- Memo to FAAC - Internal Audit Info Pre-FAAC 11- 06-2013
- Internal Audit Planning Procedures and Example
- Retirement - Benefit Payment Tests - Procedure, Explanation, and Logs
- Examples of Various Internal Control Reviews
- Memo to FAAC - Internal Audit Info Pre-FAAC 11- 06-2013
- Memo to FAAC - Internal Audit Department Charter 11-19-2013
- Memo to FAAC - External Financial Auditors 11- 22-2013
- Memo to FAAC - Internal Audit Plan - Signed 03- 04-2014
- Memo to FAAC -IAD Policies and Procedures 05- 21-2014
- Memo to FAAC - Internal Audit Department Resources Budget 05-23-2014
- Memo to FAAC - Internal Audit Plan Status Report 05-30-2014
- Memo to FAAC - Internal Audit Report on Data Security 05-30-2014
- Memo to FAAC - Strategic Planning 08-28-2014
- Memo to FAAC - Certification of No Conflicts 08- 27-2014

## Appendix H: List of Documents Reviewed

- Memo to FAAC - Internal Audit Report On Operational Reports 08-28-2014
- Memo to FAAC - External Investment Accounts 08-29-2014
- Memo to FAAC - Internal Audit Plan Status Report 08-29-2014
- Memo to FAAC - Internal Audit Plan Status Report 08-29-2014
- Data Integrity Policy
- IT Strategic Plan 2014
- IT Architecture v. 2
- Data Dictionary
- PEBA Operational Information Technology Systems
- Software Inventory Summary Report Systems
- PEBA IT Projects Report
- Application Development Priorities
- Information Security Policy - Combined 6-1-2014
- Other IT Procedures
- System Shutdown-Startup Procedures
- Memo to FAS Regarding Information Technology User Satisfaction 09-26-2014
- PEBA IT Survey Results 12-10-2014
- PEBA IT Business Projects on hold
- PEBA IT Systems Projects on hold
- New User Procedures
- Helpdesk Operations responsibilities 2013
- IT Form 8416
- IT Form 8410
- IT Form 8204
- SOC Incident 24194 - Response to ISAC
- SOC Incident 25391 - Response to ISAC
- SOC Incident 27353 - Response to ISAC
- Info Sec Roles and Responsibilities
- Business Continuity Memo and Scope of Work
- Business Continuity Memo and Scope of Work
- Business Continuity Memo and Scope of Work
- Business Continuity Memo and Scope of Work
- Retirement - Investment Accounting Policies
- Insurance - Accounting Policies and Procedures
- Retirement - GL Accounting Manual
- PEBA budget performance reports FY 2013 and FY 2014
- Detailed cost reports for FY 2013 and FY 2014
- List of all PEBA related legislation in 2013/2014 session with notes regarding Bills passed or failed
- Bill S 0954 (which did not pass) with section by section explanations
- Bill S 0954 Substantive and Technical Changes
- NASRA Survey on Internal Audit Processes - May 2004
- PEBA Interviewees - Contact Information 10-02- 2014
- PEBA External Interviewees - Contact Information 10-16-2014
- List of Current Initiatives by Area

## Appendix H: List of Documents Reviewed

- Insurance Finance Program Management Documents
- R and S and PP - 2014 and 2015 Unit Initiatives
- Board Calendar - Different Views
- 2014 Correspondence with STO
- PBM Implementation Issues List
- STO Investment Policies
- List of PEBA Positions Lost
- Operational Systems Assessment- Managers Presentation\_FAAC\_2014\_09
- Health Plan Pilot Programs, Grandfather Issues, and Claim Procedures - E-Mail Response 10-10-2014
- Plan Determination Letters from the IRS - E-Mail Response 10-13-2014
- Deloach Stolen Laptop - E-Mail Response 10-14-2014
- Information Regarding Legal Requirements Compliance - E-Mail Response 10-14-2014
- Fees for Outside Counsel E-Mail Response 10-14-2014
- Document Retention Policies and Procedures
- Memo to FAS Regarding Document Retention Policies and Procedures
- Deferred Comp Recordkeeping Services
- ORP Recordkeeping Services
- DC - Elliott Davis SAS 114 Report for FY 2013
- Audited Financial Statements for Retirement and Insurance 2009 and 2010
- Insurance - Vendor Contract Performance Metrics 2014

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                         | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 6.4: The actuary, in conjunction with the PEBA staff and subject to approval by the Board, should develop and recommend all actuarial assumptions for the pension plan and other benefit plans. If the state law placing responsibility for setting the investment return assumption with the Legislature is not changed, there should be a prescribed periodic review process adopted by the State Legislature. | 1 = Critical                                  | Medium                                             | Yes                                 | General Assembly                                                        | Actuarial                                                                                                          |
| 1.8: Training of new Trustees and periodic Board fiduciary education updates should include expanded treatment of the duties of loyalty and impartiality, the different roles of Trustees and plan sponsors and the distinct functions of the Board and staff.                                                                                                                                                   | 1 = Critical                                  | Easy                                               | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.9.1: The Board should engage in a deliberative process to develop a conceptual framework governing the delegation of authority and reservation of powers to the Board. Given the inherent conflicts between Trustees and staff in this exercise, Consideration should be given to engaging an independent expert to assist with the process.                                                                   | 1 = Critical                                  | Easy                                               | Yes                                 | Yes (outside specialist firm)                                           | Board                                                                                                              |
| 1.13: The Board should evaluate mechanisms to improve its two-way communication with stakeholders.                                                                                                                                                                                                                                                                                                               | 1 = Critical                                  | Easy                                               | Yes                                 | Stakeholders                                                            | Board                                                                                                              |
| 4.3.2: The PEBA Board should play a more active role in reaching out to employee groups on a regular basis to improve communications.                                                                                                                                                                                                                                                                            | 1 = Critical                                  | Easy                                               | Yes                                 | Stakeholders                                                            | Board                                                                                                              |
| 4.5.3: Similar to Recommendation 4.3.2, the PEBA Board should play a more active role in reaching out to retiree groups on a regular basis to improve communications.                                                                                                                                                                                                                                            | 1 = Critical                                  | Easy                                               | Yes                                 | Stakeholders                                                            | Board                                                                                                              |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                                                                | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 7.4.1: PEBA should provide periodic fiduciary training to staff and Board members through standardized onboarding education, regular updates and use of examples that are targeted to key issues.                                                                                                                                                                                                                                                       | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 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. Appendix A also describes options for consideration in addressing this Recommendation from the Funston Fiduciary Audit Report on RSIC, which covered some of the same issues. | 1 = Critical                                  | Difficult                                          | No                                  | General Assembly                                                        | Legislation                                                                                                        |
| 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 = Critical                                  | Difficult                                          | No                                  | General Assembly                                                        | Legislation                                                                                                        |
| 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 = Critical                                  | Difficult                                          | No                                  | General Assembly                                                        | Legislation                                                                                                        |
| 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.                                                                                                                                                                                                                                             | 1 = Critical                                  | Difficult                                          | No                                  | General Assembly                                                        | Legislation                                                                                                        |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                                                                                                                     | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 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 = Critical                                  | Difficult                                          | No                                  | General Assembly                                                        | Legislation                                                                                                        |
| 10.2: PEBA should determine if current headcount is adequate in all areas.                                                                                                                                                                                                                                                                                                                                                                                                                                   | 1 = Critical                                  | Difficult                                          | Yes                                 | No                                                                      | Organization                                                                                                       |
| 10.5: PEBA should increase its budget for health insurance strategy development and planning.                                                                                                                                                                                                                                                                                                                                                                                                                | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Organization                                                                                                       |
| 3.4.2: Human resources should develop a training policy and program that provides for new employee orientation. New Employee Orientation should include a general organizational overview of PEBA's functions and services.                                                                                                                                                                                                                                                                                  | 1 = Critical                                  | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 7.4.2: PEBA should formalize a staff training schedule to ensure that consistent ethics and compliance training is conducted.                                                                                                                                                                                                                                                                                                                                                                                | 1 = Critical                                  | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 10.1: PEBA should review its focus on low cost of retirement operations and ensure there is an adequate level of investment in infrastructure to continue to provide a high level of customer service.                                                                                                                                                                                                                                                                                                       | 1 = Critical                                  | Difficult                                          | Yes                                 | No                                                                      | Planning                                                                                                           |
| 10.4: To achieve PEBA's stated strategies of further integration and improved infrastructure, it should request at least a temporary increase in administrative expenses and professional and consulting fees for several years.                                                                                                                                                                                                                                                                             | 1 = Critical                                  | Difficult                                          | Yes                                 | General Assembly                                                        | Planning                                                                                                           |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 11.1: PEBA should complete its comprehensive assessment of its existing IT infrastructure and business systems.                                                                                                                                                                         | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Planning                                                                                                           |
| 11.10: As PEBA completes its Operational Systems Assessment it should consider what, if any, additional methodologies and skills will be required for the Information Technology Department to effectively support a new IT plan.                                                       | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Planning                                                                                                           |
| 11.4: After the Operational Systems Assessment is completed, the IT department should lead an effort to develop a long-term IT strategic plan which supports the plan infrastructure direction.                                                                                         | 1 = Critical                                  | Difficult                                          | Yes                                 | General Assembly                                                        | Planning                                                                                                           |
| 11.6.1: PEBA should continue to move forward with its plans to conduct a comprehensive IT Operations Assessment to identify common business process, technology and develop a roadmap to develop its next generation of systems to support the strategic direction of the organization. | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Planning                                                                                                           |
| 4.1: PEBA should develop a comprehensive communications strategy and plan.                                                                                                                                                                                                              | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Planning                                                                                                           |
| 4.11: As part of its comprehensive communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with key legislators.                                                                                                        | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Planning                                                                                                           |
| 4.8: As part of its strategic communications strategy and plan (see Recommendation 4.1), PEBA should include initiatives which improve communications with the general public.                                                                                                          | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Planning                                                                                                           |
| 6.9: PEBA should explore additional consulting services for the Health Insurance plans to assist in developing long-term strategies to reduce cost and improve health outcomes.                                                                                                         | 1 = Critical                                  | Medium                                             | No                                  | Procurement Process                                                     | Planning                                                                                                           |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                             | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 9.1: PEBA should continue its efforts to conduct a comprehensive assessment of its operational infrastructure and business processes.                                                                                | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Planning                                                                                                           |
| 2.1: To provide the most assistance for Board members in understanding and upholding the ethical requirements, the ethics policy should be expanded to provide an additional framework around the ethical standards. | 1 = Critical                                  | Medium                                             | Yes                                 | No                                                                      | Policy                                                                                                             |
| 2.12.2: The PEBA Trustee Education Policy should specify topics on which training is needed and include mandatory fiduciary training on a periodic basis, and could be linked with the self-assessment process.      | 1 = Critical                                  | Easy                                               | Yes                                 | No                                                                      | Policy                                                                                                             |
| 7.5: PEBA should confirm that ORP and Deferred Compensation investment advisors acknowledge their compliance with the SEC 'pay to play' regulations and state requirements.                                          | 1 = Critical                                  | Easy                                               | No                                  | No                                                                      | Policy                                                                                                             |
| 5.1.2: PEBA should revise its written benefits administration procedures to reflect changes required by the new administration software which will be implemented as part of the new benefits platform.              | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.7.1: PEBA should obtain the email addresses of a much higher proportion of its members, particularly retirees, to ensure they receive news electronically.                                                         | 1 = Critical                                  | Difficult                                          | No                                  | Members                                                                 | Process                                                                                                            |
| 4.2.2: The new website should include additional self-service functions to reduce the requirement for submission of paper forms and to provide more member information and tools online.                             | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |
| 4.6.1: PEBA should ensure that its new website has significantly improved functionality for accepting online submission of forms and reports.                                                                        | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |

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| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                   | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 8.13.2: PEBA should evaluate new phone and email management systems and consider acquiring newer technologies if they could improve service levels and/or staff productivity levels.                                                                                                                                                                       | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |
| 8.8: As PEBA develops its new website, it should place a high emphasis on maximizing self-service capabilities for both members and employers.                                                                                                                                                                                                             | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |
| 9.2: PEBA should continue to conduct annual network and security vulnerability tests to ensure its networks and other infrastructural processes are working as intended. Greater use should be made of in-house based security monitoring tools to identify and protect its networks from unauthorized access and unintentional disclosure of member data. | 1 = Critical                                  | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |
| 6.1: PEBA should determine whether additional assistance from the actuarial team would be beneficial, as identified under Recommendations 6.6, 6.8 and 6.9 below.                                                                                                                                                                                          | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Actuarial                                                                                                          |
| 6.5: PEBA staff should develop procedures, in conjunction with the actuary, to determine when and how to adopt annuity option factor changes.                                                                                                                                                                                                              | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Actuarial                                                                                                          |
| 6.6: PEBA should consider closer engagement between the PEBA Board, staff, actuary, and the RSIC Board and staff in order to better understand how investment return projections under various asset allocation models may impact plan liabilities and costs.                                                                                              | 2 = Important                                 | Medium                                             | No                                  | RSIC                                                                    | Actuarial                                                                                                          |
| 6.7: PEBA should adopt a policy of conducting regular independent actuarial audits.                                                                                                                                                                                                                                                                        | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Actuarial                                                                                                          |
| 1.10: The Board should further improve its Bylaws and Committee Charters by:                                                                                                                                                                                                                                                                               | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                       | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 1.10a: Formalizing the process for the development of meeting agendas;                                                                                                                                                                                         | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10b: Creating a Charter for the Executive Committee that includes a framework for evaluation of the Executive Director;                                                                                                                                      | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10c: Removing the provision that Committee members serve at the pleasure of the Board Chairman;                                                                                                                                                              | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10d: Establishing procedures for calling a Committee meeting that parallel those for convening a Board meeting;                                                                                                                                              | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10e: Developing position descriptions for Board and Committee officers;                                                                                                                                                                                      | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10f: Creating a Board disciplinary policy;                                                                                                                                                                                                                   | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10g: Formalizing a process for approving the Board Chairman's educational program attendance and cost reimbursements;                                                                                                                                        | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.10h: Including the Board's Self-Assessment process in the Bylaws and using it to identify Trustee training priorities.                                                                                                                                       | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |
| 1.11: The Board should periodically engage a consultant to facilitate the Board's self-assessment and improvement process, perhaps on a biennial basis.                                                                                                        | 2 = Important                                 | Difficult                                          | Yes                                 | Procurement Process                                                     | Board                                                                                                              |
| 1.12: The Board should proceed with prioritizing enhancement of PEBA's risk identification, risk management and compliance functions. Consideration should be given to the appropriate assignment of Committee oversight responsibilities for this initiative. | 2 = Important                                 | Difficult                                          | Yes                                 | May require additional resources                                        | Board                                                                                                              |
| 1.9.2: The Board should continue to prioritize and spend more time on strategic planning, identification of program goals, desired                                                                                                                             | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Board                                                                                                              |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                          | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to Accomplish | Board Involvement Needed | Other State Entities/<br>Outside parties cooperation needed | Theme<br>(Actuarial, Board, Legislation, Organization, Planning, Policy, Process, Risk, Systems) |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|--------------------------|-------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| outcomes, implementation strategies, targets and measures to successfully meet PEBA's challenges.                                                                                                                                                                                                                                                 |                                               |                                                 |                          |                                                             |                                                                                                  |
| 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.                                                                                                                             | 2 = Important                                 | Difficult                                       | No                       | General Assembly                                            | Legislation                                                                                      |
| 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.                                                                          | 2 = Important                                 | Difficult                                       | No                       | General Assembly                                            | Legislation                                                                                      |
| 1.7: The statutory requirement that the PEBA Board meet monthly throughout the year should be repealed.                                                                                                                                                                                                                                           | 2 = Important                                 | Difficult                                       | No                       | General Assembly                                            | Legislation                                                                                      |
| 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. | 2 = Important                                 | Medium                                          | No                       | General Assembly                                            | Legislation                                                                                      |
| 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.                                                                                       | 2 = Important                                 | Difficult                                       | No                       | General Assembly                                            | Legislation                                                                                      |
| 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                                                                                                                                                                            | 2 = Important                                 | Medium                                          | No                       | General Assembly                                            | Legislation                                                                                      |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                                                                                                                                                               | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| acknowledged” written notification to PEBA.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                               |                                                    |                                     |                                                                         |                                                                                                                    |
| 11.6.2: PEBA should continue to assess potential third-party IT vendors which may be able to provide additional legacy “Natural language” programming support in the event a large number of existing PEBA programming staff retire or leave the organization.                                                                                                                                                                                                                                                                                         | 2 =<br>Important                              | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 2.11.1: PEBA should determine whether it needs additional experienced procurement resources to address upcoming requirements.                                                                                                                                                                                                                                                                                                                                                                                                                          | 2 =<br>Important                              | Easy                                               | No                                  | No                                                                      | Organization                                                                                                       |
| 3.3: PEBA should continue to fill remaining vacant positions in order to maintain sufficient staffing in all areas to effectively and efficiently perform all functions.                                                                                                                                                                                                                                                                                                                                                                               | 2 =<br>Important                              | Easy                                               | No                                  | No                                                                      | Organization                                                                                                       |
| 3.4.1: Each PEBA business area should develop a specialized staff training and education policy and program for staff in their area.                                                                                                                                                                                                                                                                                                                                                                                                                   | 2 =<br>Important                              | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 3.5.2: Succession planning should be a higher priority. Executive Staff and managers should maintain organizational charts of each business unit that reflect the time remaining to retirement eligibility of individual staff members and regularly discuss anticipated vacancies and plan for future staffing needs and training. The discussion should also include the possibility of back-filling positions where vacancies are anticipated to provide that the replacement is fully trained when the retiring staff member vacates the position. | 2 =<br>Important                              | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 3.6.1: As the new technology platform and processes are developed, PEBA should implement additional operational consolidations                                                                                                                                                                                                                                                                                                                                                                                                                         | 2 =<br>Important                              | Difficult                                          | No                                  | No                                                                      | Organization                                                                                                       |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                                             | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 9.3.2: PEBA should develop and implement a training program for business unit staff in the event the data center recovery plan has to be activated.                                                                                                                                                                                                                                                                                  | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 1.9.3: The strategic planning process should give particular consideration to risk identification, compliance issues and staff development, over both short- and long-term (three to five years) time horizons.                                                                                                                                                                                                                      | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Planning                                                                                                           |
| 11.11: PEBA should continue its efforts to address its business continuity planning deficiencies.                                                                                                                                                                                                                                                                                                                                    | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Planning                                                                                                           |
| 11.5: Further efforts need to be made to move from a data center disaster recovery plan orientation to an enterprise wide business continuity focused plan.                                                                                                                                                                                                                                                                          | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Planning                                                                                                           |
| 2.12.1: With most Board members only needing six additional credits after attending the Board's annual retreat, the Board should determine whether the Board members are receiving sufficient training from independent outside sources. If not, the policy should be revised to require additional credits or limit the number of credits from the Board retreat and staff training that can be used to meet training requirements. | 2 = Important                                 | Easy                                               | Yes                                 | No                                                                      | Policy                                                                                                             |
| 5.1.1: PEBA should continue to maintain internal controls and keep its written policies and procedures current.                                                                                                                                                                                                                                                                                                                      | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Policy                                                                                                             |
| 6.2: PEBA should develop an internal policy that documents its competitive RFP process in future procurements of actuarial services.                                                                                                                                                                                                                                                                                                 | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Policy                                                                                                             |
| 11.3: PEBA should continue its efforts to address the IT control procedural deficiencies noted by their external auditors. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance                                                                                                                                                                                                          | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                            | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
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| audit to determine that the control enhancements address the specific concerns noted.                                                                                                                                                                               |                                               |                                                    |                                     |                                                                         |                                                                                                                    |
| 4.6.2: PEBA communications should review its communications process on legislative changes as they relate to employers and ensure that it results in timely employer updates.                                                                                       | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Process                                                                                                            |
| 7.3: PEBA should review its printed training materials, reports and use of protected health information to make sure its minimum necessary standards are being consistently applied.                                                                                | 2 = Important                                 | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.17: PEBA should determine if assigning responsibility for monitoring insurance customer service to a single manager in the insurance organization could help focus the reporting and provide helpful input during contract negotiations.                          | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Process                                                                                                            |
| 8.4: PEBA should develop a more standardized approach for performance monitoring and customer satisfaction surveys with common tools, data and reporting.                                                                                                           | 2 = Important                                 | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.5.1: PEBA should identify the key areas and metrics for customer service monitoring and develop a comprehensive, integrated customer service monitoring framework which is used to drive its customer surveys and follow-up improvement programs.                 | 2 = Important                                 | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.5.2: The PEBA Customer Service Department should establish a small group with expertise in customer service metrics and monitoring, or conversely, utilize an outside specialist firm to assist in developing its customer service monitoring approach and tools. | 2 = Important                                 | Medium                                             | No                                  | Yes (outside specialist firm)                                           | Process                                                                                                            |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                        | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 8.6: PEBA should re-evaluate its satisfaction surveying process to include single activity surveys for disability, pension inceptions, withdrawals and transfers-out and service credit purchases.                                                                                                                                                                                              | 2 = Important                                 | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 9.3.1: PEBA should address identified business continuity planning deficiencies.                                                                                                                                                                                                                                                                                                                | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 9.4: PEBA should continue its efforts to address the deferred compensation control procedural deficiencies noted by PEBA's staff. Once the deficiencies have been remediated, Internal Audit should conduct a follow-up compliance audit to determine that the control enhancements address the specific concerns noted.                                                                        | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 11.2: PEBA should increase the frequency of a full enterprise wide risk assessment to ensure that Internal Audit's Plan for the upcoming year reflects the most significant risks to the organization (see also Recommendations 2.7.1 and 2.7.2).                                                                                                                                               | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Risk                                                                                                               |
| 2.5: PEBA should increase the frequency of its enterprise-wide risk assessment. Currently, one is conducted every five years; however, given the significant changes that have occurred in PEBA's leadership, as well as proposed changes, conducting a more frequent risk assessment would help to ensure that new issues or concerns are promptly identified and prioritized for remediation. | 2 = Important                                 | Difficult                                          | Yes                                 | No                                                                      | Risk                                                                                                               |
| 2.7.2: The development of a risk management policy (including risk appetite and risk tolerance) should be the responsibility of executive management with input from Internal Audit and other stakeholders.                                                                                                                                                                                     | 2 = Important                                 | Difficult                                          | Yes                                 | No                                                                      | Risk                                                                                                               |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                            | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 2.7.3: An executive should be assigned responsibility and accountability for the assessment and management of specific risks within each business function and overall based on factors such as impact, velocity and vulnerability. Internal Audit and others can support management in their self-assessments but operating management should be held accountable for the results. | 2 = Important                                 | Medium                                             | No                                  | No                                                                      | Risk                                                                                                               |
| 2.7.4: The Board should identify the type and magnitude of risks which ought to come to its attention, e.g., financial, legal, operational, organizational, reputational, strategic.                                                                                                                                                                                                | 2 = Important                                 | Medium                                             | Yes                                 | No                                                                      | Risk                                                                                                               |
| 2.7.5: The Board should require that the presentation of information for all major decisions include a risk assessment including the risk of inaction.                                                                                                                                                                                                                              | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Risk                                                                                                               |
| 2.7.6: Internal Audit should focus its audit plans on areas that present the highest inherent risk and which rely most of the effectiveness of controls. Time permitting; Internal Audit should focus its consulting efforts on areas of high inherent risk and low control effectiveness.                                                                                          | 2 = Important                                 | Easy                                               | No                                  | No                                                                      | Risk                                                                                                               |
| 4.2.1: PEBA should develop the planned consolidated website as soon as practical to improve integration of and access to all information.                                                                                                                                                                                                                                           | 2 = Important                                 | Difficult                                          | No                                  | No                                                                      | Systems                                                                                                            |
| 6.8: PEBA should consider having the actuary validate the premium rates once PEBA completes the calculation process.                                                                                                                                                                                                                                                                | 3 = Consider                                  | Easy                                               | No                                  | No                                                                      | Actuarial                                                                                                          |
| 4.5.2: The PEBA Board should consider developing a process and protocol for receiving and considering public comments before its meetings.                                                                                                                                                                                                                                          | 3 = Consider                                  | Easy                                               | Yes                                 | Stakeholders                                                            | Board                                                                                                              |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                                                                                                                                                                                   | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 3.1.1: PEBA should consider adding the title of Deputy Executive Director to the title of Chief Operating Officer to provide a more streamlined flow of communication between the Executive Director and executive staff, as well as create a succession plan for the Executive Director position.                                                                                                                                         | 3 = Consider                                  | Medium                                             | Yes                                 | No                                                                      | Organization                                                                                                       |
| 3.1.2: Over the longer term, PEBA should consider creating the position of a leader of retirement programs who would have responsibility for both defined benefit and defined contribution and savings programs.                                                                                                                                                                                                                           | 3 = Consider                                  | Medium                                             | Yes                                 | No                                                                      | Organization                                                                                                       |
| 3.5.1: The staff training and education policy should provide for cross-training and rotation of staff to other, similarly classified positions within the business functions for cross-training purposes.                                                                                                                                                                                                                                 | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Organization                                                                                                       |
| 3.6.2: The budgeting process for all areas should be more coordinated and collaborative. A formal budget process should be developed and include all department heads in its development. Integration of the budget process will reduce silos and enhance an enterprise approach to administrative functions.                                                                                                                              | 3 = Consider                                  | Easy                                               | No                                  | No                                                                      | Planning                                                                                                           |
| 2.6: PEBA should have a formal compensation policy which documents its acknowledgement of its status as a South Carolina State government agency and its compliance with the State's Office of Human Resources policies, job classifications system and pay bands. A simple statement and reference to the State policies to which it adheres would provide transparency of PEBA's compensation policy to its employees and to the public. | 3 = Consider                                  | Easy                                               | Yes                                 | No                                                                      | Policy                                                                                                             |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                                                                                                    | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 11.7: PEBA should continue to work closely with the State's Information Sharing and Analysis Center (SC-ISAC) along with other third-party information technology consulting firms to proactively assess existing and trending threats to information and network security. | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 11.8: Issues and error correcting processes should be shared across functional business units to ensure that similar errors in one beneficiary system are also being addressed in other similar application systems.                                                        | 3 = Consider                                  | Easy                                               | No                                  | No                                                                      | Process                                                                                                            |
| 11.9: The Information Technology Department should consider developing a formal IT user satisfaction feedback process                                                                                                                                                       | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 2.11.2: PEBA should consider revising its procurement process to provide for a post-audit process by Internal Audit, potentially using a questionnaire.                                                                                                                     | 3 = Consider                                  | Easy                                               | No                                  | No                                                                      | Process                                                                                                            |
| 3.8: Each of PEBA's departments should create and maintain a standard operating procedures manual documenting its process for performing its functions.                                                                                                                     | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 4.3.1: PEBA should consider mailing newsletters to members with an "opt-out" electronic option for either email delivery or an RSS newsfeed to ensure that all members receive PEBA news on a timely basis.                                                                 | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 4.5.1: Consistent with Recommendation 4.3.1, PEBA should consider mailing newsletters to retirees and survivors with an "opt-out" electronic option for either email delivery or an RSS newsfeed to ensure that all retirees receive PEBA news on a timely basis.           | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 4.6.3: PEBA should determine whether having an employer advisory group to provide feedback in a structured manner would be beneficial.                                                                                                                                      | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |

## Appendix I: List of Recommendations in Order of Priority

| RECOMMENDATIONS<br>(numbering corresponds to the numbering of conclusions and not every conclusion has a recommendation)                                                                              | 1 = Critical<br>2 = Important<br>3 = Consider | Difficult vs<br>Medium vs<br>Easy to<br>Accomplish | Board<br>Involve-<br>ment<br>Needed | Other State<br>Entities/<br>Outside<br>parties<br>cooperation<br>needed | Theme<br>(Actuarial,<br>Board,<br>Legislation,<br>Organization,<br>Planning, Policy,<br>Process, Risk,<br>Systems) |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|----------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 5.3: PEBA should consider expanding the scope of information provided on annual benefit statements.                                                                                                   | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 7.2: In conjunction with outside legal counsel, PEBA legal staff should continue to perform periodic reviews of changes in the law and the plans' compliance with federal and state law requirements. | 3 = Consider                                  | Medium                                             | No                                  | No                                                                      | Process                                                                                                            |
| 8.13.1: PEBA should consider if expanded hours for its call center would result in improved customer service.                                                                                         | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.14: PEBA should consider whether offering one-on-one counseling sessions at employer sites would result in improved customer service and participation levels.                                      | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.15: PEBA should consider increasing the number of retirement presentations it offers in the field to reduce the size of the groups and allow more individual attention.                             | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.16: PEBA should consider adding additional information to member statements to help them better understand their future options.                                                                    | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 8.7.2: PEBA should consider alternative means of reaching members if they do not use email or the internet.                                                                                           | 3 = Consider                                  | Difficult                                          | No                                  | No                                                                      | Process                                                                                                            |
| 2.7.1: Internal Audit should continue to develop a comprehensive risk self-assessment tool for PEBA as an integrated organization.                                                                    | 3 = Consider                                  | Medium                                             | Yes                                 | No                                                                      | Risk                                                                                                               |
|                                                                                                                                                                                                       |                                               |                                                    |                                     |                                                                         |                                                                                                                    |

## Appendix J: Comments on Draft Final Report from RSIC

**Randall Miller**

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**From:** Andrew Chernick <AChernick@ic.sc.gov>  
**Sent:** Monday, January 12, 2015 11:44 AM  
**To:** Randall Miller  
**Cc:** rfunston@funstonadv.com; Lamkin, Brian (blamkin@oig.sc.gov)  
**Subject:** Funston Draft PEBA report feedback from RSIC

Hi Randy,

Hope you and the rest of the Funston team is doing well. I wanted to communicate any feedback we had on Funston PEBA draft report. We limited feedback to things specific to RSIC, as we have no doubt that PEBA (and yourself and others) I am sure are doing a thorough review of entire report. Most of our comments are very minor, though one will require some redacting of investment names. If you have any questions please do not hesitate to contact me:

Appendix E:

- E-5: Jon Rychener name misspelled
- Investment Commitment detailed schedule ( E30-31) – Some of the underlying SP investments are confidential and exempt from disclosure under FOIA. We ask that these name be redacted or removed. We are happy to work with you/PEBA on easiest way to update this schedule to retain its necessary confidentiality but still show the support that is needed for purposes Appendix E.

Appendix G:

- No mention of Michael Hitchcock, Executive Director of RSIC on “List of Interviews”

Appendix I:

- incorrect header

Thanks—Andrew



Andrew Chernick, CPA | Managing Director of Operations & Operational Due Diligence  
S.C. Retirement System Investment Commission  
p 803.737.6083 | f 803.737.7070 | [AChernick@ic.sc.gov](mailto:AChernick@ic.sc.gov)  
1201 Main Street | Suite 1510 | Columbia SC 29201

## Appendix K: Comments on Draft Final Report from STO



**THE HONORABLE CURTIS M. LOFTIS, JR.**  
State Treasurer

January 12, 2015

Rick Funston  
Managing Partner  
Funston Advisory Services LLC  
591 Rudgate Road  
Bloomfield Hills, MI 48304

Dear Mr. Funston,

Please see the attached memorandum from the State Treasurer's Office responding to the Draft Final Report of the Fiduciary Performance Audit of PEBA which this Office received a copy of on December 29, 2014. Given the late date of receipt, this Office is unable to provide as comprehensive and detailed a response as it provided during the RSIC audit.

Although the Report mentions the State Treasurer numerous times and with regards to several issues of great importance, at no time did Funston reach out to the State Treasurer or this Office to discuss such issues. This lack of communication has likely contributed to deficiencies, inaccuracies, and an apparent lack of understanding of critical matters discussed in the Report. Most unfortunately, this lack of communication has resulted in several important issues being completely unaddressed. The \$700,000 of public funds spent on this audit would have been much better utilized had it been focused on specific problems that are likely to be more problematic as opposed to broad, high level issues with theoretical solutions, at best. The bias reflected in the Report gives no weight to the simple fact that elected officials are an important part of our system of government and should have important roles in the oversight of the administration of a \$30 billion dollar pension trust fund for public employees.

In closing, it is my firm belief that approximately 1.5 million taxpayer dollars have been spent on biased audits for both PEBA and RSIC, neither of which serves the interests of the taxpayers or the beneficiaries of the System. Rather, these audits will ultimately have the effect of contributing to higher taxes, increased unfunded liabilities, and less accountability and transparency in state government.

Sincerely,

A handwritten signature in black ink, appearing to read "Curtis M. Loftis, Jr.", is written over a circular embossed seal of the South Carolina State Treasurer's Office.

Curtis M. Loftis, Jr.  
South Carolina State Treasurer

Enclosure

cc: Patrick J. Maley, Inspector General  
Clarissa Adams  
Robin Johnson

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## Appendix K: Comments on Draft Final Report from STO



**THE HONORABLE CURTIS M. LOFTIS, JR.**  
State Treasurer

### MEMORANDUM

TO: Rick Funston  
FROM: State Treasurer's Office  
RE: Draft Final Report of PEBA Audit  
DATE: January 12, 2015

The State Treasurer's Office ("STO") received a copy of the Draft Final Report (the "Report") of the Fiduciary Performance Audit of the S.C. Public Employee Benefit Authority ("PEBA") on December 29, 2014. The Report mentions the STO numerous times and with regards to several issues of great importance. However, at no time did Funston reach out to the STO to discuss these issues. This lack of communication has likely contributed to the deficiencies, inaccuracies, and an apparent lack of understanding of critical matters discussed in the Report. With that in mind, the STO believes certain issues warrant reconsideration and revision.

First, the STO takes exception to A-5 of the Report which makes disparaging insinuations about the Treasurer personally and boldly implies that, from a legal standpoint, the Treasurer has breached his fiduciary duty of loyalty to the Retirement System's beneficiaries. Relying on some erroneous assumption that the Treasurer, in his role as statutory custodian, withholds the release of funding for investments approved by Retirement System Investment Commission ("RSIC"),<sup>1</sup> the Report suggests the Treasurer has "unintentionally" breached his fiduciary duty of loyalty and has done so based on his "subjective" claim that he acted in good faith. When these insinuations are considered in the full context of the analysis on A-5 and the choice of language used therein, the reader is clearly led to believe the Treasurer makes claims of taking good faith actions which are untruthful or, at best, based on some dubious understanding of his fiduciary duties. Furthermore, the Delaware court opinion relied upon in the analysis is not, as the Report indicates, factually analogous for several reasons. First, the Report does not even delineate the alleged facts concerning the Treasurer to which those of the Delaware case are being compared. Moreover, the facts of the Delaware case (which span approximately twenty pages) involve a director of a company who, knowing the company was on the verge of failing due to a cash shortfall, provided the company's only potential investor with confidential company information and bargaining advice in an attempt to advance his own interests and his personal agenda for the company. The insinuation that the Treasurer has engaged in similar conduct – in addition to being completely inaccurate, defamatory, and reckless – calls into question the objectivity of the audit.

We would also add that any determination as to whether any other fiduciary has violated the duty of loyalty in a given instance is a fact-intensive matter for a court as evidenced by the twenty page statement of facts in the Delaware case. Such matters are outside the purview of a third-party auditing firm whose staff is not even licensed to practice law in South Carolina. Furthermore, we find it ironic that Funston chose to include the legal analysis and opinions on A-5 in light of the following statement on A-1

<sup>1</sup> We would challenge Funston to identify one investment approved by RSIC which the STO has failed to release funding for.

## Appendix K: Comments on Draft Final Report from STO

of the Report: "As we are not South Carolina law experts, [this Appendix] is not a legal opinion and is not intended to constitute legal advice." It seems the Appendix does exactly what it purports not to do.

Second, we note the STO has no outright objection to the Report's recommendations that the General Assembly focus on constitutional and/or statutory amendments that would transfer the STO's investment authority with regards to insurance trust funds and Deferred Compensation Program funds to RSIC. With that being said, we are troubled by the Report's numerous statements in support of this recommendation which clearly suggest the STO is either unqualified to exercise the investment authority statutorily granted it or otherwise possesses inferior investment expertise and knowledge as compared to RSIC. By way of examples, the Report: recommends these investment functions be transferred "to RSIC, *the State's established investment expert*"; states that "[a]lthough the General Assembly established the RSIC to house the *State's investment expertise*, the State Treasurer still approves deferred compensation investment options and invests insurance program trust fund assets"; asserts RSIC is "*the most qualified State entity*" to provide such investment services; and states that "fiduciary authority for investments is not fully aligned with *relevant fiduciary expertise*." Such disparaging assertions as to the STO's investment expertise are completely uncalled for and, as explained below, unfounded.

Although it is clear from the 2005 act which created RSIC that the General Assembly intended for it to be the sole state agency responsible for investing the assets of the Retirement System, nothing in RSIC's enabling legislation or any other statutory provision indicates it was established as the State's foremost authority on *all* investment-related matters. Notably absent from the Report is the mention of any discernable evidence which substantiates its assertions as to the STO's purported lack of sufficient investment expertise.<sup>2</sup> Furthermore, the STO has more investment experience than any other state agency as its statutory investment authority dates back to at least 1869. See *State v. Cardozo*, 8 S.C. 71 (1876) (discussing 1869 act authorizing State Treasurer to invest funds deposited with him by Land Commissioner in bonds of the State); *Hopkins v. Clemson Agricultural College*, 77 S.C. 12 (1907) (discussing 1890 joint resolution directing State Treasurer to invest and reinvest funds received by him from Clemson bequest). Given the fact that this State's pension fund consistently rates in the bottom twenty percent – if not worse – in overall investment performance when compared to its peer group, one could question the overall level of expertise directing our State's pension investments, much less the assertion such investment expertise is superior to any other agency in the State.

Third, we have just a few comments and concerns regarding the Potential Options for Realignment of the Duties of the State Treasurer found on A-13. Option 1 is not feasible as the STO simply cannot abdicate or surrender its statutory duties and authority as custodian in the absence of legislation to the contrary. Nor does the STO believe it would be prudent to do so. As for Options 2, 3, and 4, we must call attention to the fact that the STO currently has a custody agreement in place with the Bank of New York Mellon. Accordingly, any potential legislation transferring some or all of the STO's custodial duties and authority must give strong consideration to, among other things, the Contract Clauses of both the federal and state constitutions.<sup>3</sup>

Fourth, the Report references "potential concerns" noted by PEBA's external auditor "with the adequacy of account information and reconciliations from the [STO] regarding allocation of securities lending losses" among funds and accounts managed by the STO in support of the contention that "fiduciary authority for investments is not fully aligned with relevant fiduciary expertise and responsibility." Such "potential concerns" as to the adequacy of information are unfounded as the STO

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<sup>2</sup> It is worth noting that several RSIC investment professionals were employed and trained by the present STO investment leadership.

<sup>3</sup> See U.S. Const. Art. I, § 10, cl. 1 ("No State shall...pass any...Law impairing the Obligations of Contracts"); S.C. Const. Art. I, § 4 ("No...law impairing the obligation of contracts...shall be passed).

## Appendix K: Comments on Draft Final Report from STO

and Bank of New York Mellon provided PEBA and the Comptroller General any and all such information related to the securities lending program. Any accounting issues related to the securities lending program or the allocation of losses related thereto are the responsibility of PEBA or the Comptroller General as the respective state agencies charged with all financial accounting for the funds of the Retirement System and the State. The STO tried to cooperate with a third-party audit addressing any such concerns, but for reasons unbeknownst to this Office the Comptroller General's Office refused to execute the auditing firm's engagement letter. Accordingly, these concerns noted by PEBA's external auditor are in no manner indicative of any purported misalignment of authority and fiduciary responsibilities within the Retirement System.

Fifth, the STO fervently disagrees with the Report's assertion that "the legislative proviso which required PEBA to investigate and report on the Bank of New York securities lending settlement" serves as an example of "recent governance problems that have diverted PEBA's attention away from its core mission." The proviso is an example of nothing more than a legislatively mandated and politically motivated fishing expedition, the purpose of which is to find some basis to discredit and criticize the two constitutional officers – the Treasurer and Attorney General – and their respective agencies that were involved in the lawsuit. While the proviso's requirements may have diverted PEBA's attention, this type of unwarranted meddling into the affairs of the executive branch should not be cited as an example of governance problems, but as an example of legislative overreach at the expense of the taxpayers.

Finally, the STO has had questions and concerns regarding the PEBA Comprehensive Annual Financial Report (CAFR) and Financial Statements for the past three years and has shared these concerns with PEBA. The STO requested that the Inspector General include a formal review of such matters by an independent third party into the request for proposals (the "RFP") for the fiduciary audit. The STO's questions and concerns were also discussed with Funston during the RFP presentation.

The Report contains 32 pages under the heading "Investigation of Footnotes to the CAFR." Unfortunately, the CAFR and financial review was stripped down to a single issue concerning commitments. Of the 32 pages, 16 are from the minutes of a May 17-18, 2012 RSIC meeting. The purpose behind the inclusion of the minutes is unclear as they do not relate to the PEBA CAFR or Financial Statements. The short review of commitments appears to focus on the Lighthouse hedge fund, footnote disclosures from other states, and the minutes of the RSIC meeting when the issue at hand is the underreporting of commitments. While the Report mentions the disclosure of \$3.964 billion in commitments as of June 30, 2013, nowhere does the Report mention the disclosure of \$9,070,547,000 in commitments as of June 30, 2014.<sup>4</sup> This represents a more than \$5 billion increase over twelve months without any detailed explanation regarding such a material increase in commitments. Accordingly, the STO respectfully requests that Funston revisit this material issue.

In closing, it is the STO's firm belief that approximately 1.5 million taxpayer dollars have been spent on biased audits for both PEBA and RSIC, neither of which serves the interests of the taxpayers or the beneficiaries of the System. Rather, these audits will ultimately have the effect of contributing to higher taxes, increased unfunded liabilities, and less accountability and transparency in state government.

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<sup>4</sup> If Lighthouse and other strategic partnerships commitments were properly included, the new commitment level would be much greater than \$9 billion and would likely approach \$12 billion.

## Appendix L: Funston Advisory Services Response to STO Comments



January 15, 2015

The Honorable Curtis M. Loftis Jr.  
South Carolina State Treasurer  
Wade Hampton Building  
1200 Senate Street  
Columbia, SC, 29211

Re: STO response to the draft PEBA Final Fiduciary Performance Audit Report

Dear Treasurer Loftis:

Thank you for your written response to our draft PEBA Fiduciary Performance Audit report. We will include your response in its entirety as Appendix K in our final report. The purpose of the draft report was to offer an opportunity to the various stakeholders to review the document in advance, ensure the facts are correctly represented, and avoid any surprises in the final report. It also serves as an opportunity to seek further clarification from stakeholders and make appropriate revisions and refinements. Hopefully, our final report will accurately reflect your input.

To put our report in context, the purpose of this Fiduciary Performance Audit was to evaluate and compare South Carolina's PEBA current governing legislation, fiduciary frameworks, policies and practices with leading practices and legislation. The purpose was not to audit, re-audit or assess the integrity of PEBA's financial reports. Such reassurance is the responsibility of CliftonLarsonAllen LLP as the external independent auditor appointed by the State Auditor.

CliftonLarsonAllen has performed a comprehensive audit of PEBA's CAFR financial statements and disclosures (including footnotes) since PEBA's formation in 2012. The role of the external financial auditor is to express an opinion over the client's financial statements (including relevant disclosures).

In the introduction to the 2014 Comprehensive Annual Financial Report (CAFR), CliftonLarsonAllen stated:

"We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion... In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Systems as of June 30, 2014, and the respective changes in its financial position for the year then

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ended in accordance with accounting principles generally accepted in the United States of America.”

In PEBA’s case, the external auditor expressed an unqualified opinion over the financial statements in each year. This type of report is issued by an auditor when the financial statements presented are free of material misstatements and are represented fairly in accordance with the Generally Accepted Accounting Principles (GAAP). This means that in the auditor’s opinion, the entity’s financial condition, position, and operations are fairly presented in the financial statements.

As distinct from a financial statement audit, the goal of the Fiduciary Performance Audit is to make recommendations to improve the governance and delivery of retirement and health benefits and services to the more than 500,000 South Carolina public retirement system beneficiaries and the participants.

This Fiduciary Performance Audit was commissioned by the Inspector General to identify strengths and weaknesses in eleven critical areas including Governance; Policy Review and Development; Organization Structure; Communications with Stakeholders; Benefits Administration; Actuarial Matters; Legal Compliance; Customer Service; Record Keeping and Security of Information; Cost of Operations; and Information Technology Systems. The scope of the review was based on input from key stakeholders, including your office.

The goal of the Fiduciary Performance Audit was to surface pragmatic opportunities for improvement in each of these areas and to recommend priorities. The audit was of legislative, structural, policy, procedural and system fiduciary issues, not individuals or incumbents. The focus was to find and fix problems, not place blame.

The State Inspector General commissioned this audit as required by legislation. The Inspector General is independent and conducted a competitive process to select our firm as the fiduciary auditor. The audit itself is intended to provide independent reasonable reassurance that the system’s fiduciary structure, policies and practices are consistent with leading practices in each of the critical areas within the scope of this review.

Given you participated in a similar review of the Retirement System Investment Commission (RSIC) conducted by our firm last year, you are familiar with our prior recommendations to reduce risk to the system and improve fiduciary performance. Our recommendations at that time sought to address the complex and duplicative fiduciary structure that inherently fosters confusion and conflict resulting from fragmented and duplicative authority held by different fiduciaries. We also made recommendations to realign fiduciary responsibility and authority to promote accountability and more effective implementation of duties.

We publicly presented our recommendations to the Senate Finance Sub-Committee to Review the Investment of State Retirement Funds in November 2014 regarding changes to the fiduciary responsibilities of the State Treasurer. A number of the structural issues faced by RSIC related to the various roles of the State Treasurer also apply to PEBA. Our findings and our

## Appendix L: Funston Advisory Services Response to STO Comments

recommendations remain unchanged regarding the fiduciary ambiguities and conflicts that would be faced by any State Treasurer with respect to either RSIC or PEBA.

As a result, we did not revisit those same fiduciary issues with you but sought to understand your concerns about PEBA specific fiduciary matters. A material misstatement of the financial statement would be a fiduciary matter. Accordingly, as the Inspector General communicated to you on November 10, 2014, we had been alerted to your concerns. We formulated our understanding of your concerns and the Inspector General himself then followed up to seek clarification from you in writing and in person.

Over the past three years, there have been multiple inquiries by you and your staff regarding certain disclosures within the footnotes of the Public Employee Benefit Authority's (PEBA) audited Comprehensive Annual Financial Report. These inquiries have generally focused on the integrity of the financial statements related to:

- 1) The appropriateness of footnote disclosures associated with Investment Commitments.
- 2) The completeness and accuracy of Investment Commitment amounts disclosed within the financial statements.
- 3) The implications of *"additional commitments exist to underlying investments within strategic partnerships"*.

STO had expressed concern that these issues may have *"significant impact on our ability to issue state debt at terms most favorable to SC."*

As a result, our firm was asked by the Inspector General to address these concerns as part of our fiduciary audit. The results of our inquiry were described in Appendix E of the draft report and are included in the Final Report. Our conclusions pertaining to each of these concerns are summarized below:

### Conclusion 1:

The footnote disclosures associated with Investment Commitments are appropriate and consistent with the requirements of Comprehensive Annual Financial Report (CAFR) as required by the Government Accounting Standards Board and are consistent with Generally Accepted Accounting Principles (GAAP) and the disclosures of a sample of peer systems.

### Conclusion 2:

The commitment amounts and fund manager types disclosed within the financial statements are appropriate. We did not identify any additional unfunded capital commitments to the reported hedge fund commitments, including Lighthouse.

### Conclusion 3:

STO has identified a statement in the PEBA CAFR footnote which has an ambiguous reference to outstanding capital commitments and drawn an erroneous conclusion that further

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commitments exist beyond those stated in the CAFR. PEBA has acknowledged the ambiguity and has prepared its FY2014 CAFR footnotes to convey the following additional disclosures:

- Clarified the use of hedge fund and commodity investments within the Alternative Investments footnote. The clarifying language that was added specifically notes that “hedge fund and commodities investments are typically made on a subscription basis with a single, initial investment with no further commitment.”
- Clarified Alternative Investment Managers and Strategic Partner definitions.
- Incorporated an information table detailing strategic partnership investments. This table consists of Total Commitments, Amount Funded to Date and Remaining Unfunded Commitments by investment type in U.S. dollars and Euros.

PEBA’s 2014 Commitment footnote can be considered a leading practice based on FAS’ benchmarking analysis of other similar state employee benefit systems’ disclosures. Despite the clarification, the external auditor’s unqualified opinion and our inquiry, your response to our draft final report appears to indicate a continued misunderstanding of what constitutes a commitment vis-a-vis investment capacity approved by the RSIC.

It is our understanding that RSIC Commissioners approve the investment capacity, or limit to which commitments can be made to a strategic partnership. However, the actual commitments are the contractual obligations agreed upon within the strategic partnership, which can be less than the Commission-approved capacity to invest. The actual commitments are determined by the Chief Investment Officer, subject to controls to ensure the limits established by the Commission are not exceeded.

PEBA now has one of the highest degrees of transparency in its new footnote regarding its commitment disclosures compared to peers. Hopefully, further misinterpretation will be avoided by this clarification.

Sincerely

A handwritten signature in blue ink, appearing to read 'RF', with a stylized flourish at the end.

Rick Funston  
Managing Partner  
Funston Advisory Services LLC