Governance Review of the Uniformed Retirement System (URS)

URS Board of Trustees Presentation

November 21, 2024

Funston Advisory Services LLC

Introductions

FAS team members:

- Rick Funston, FAS founder and governance and risk expert
- Susan Lau, investment subject matter expert
- Randy Miller, project manager
- Nick Zuiker, independent legal advisor

Overview

- Funston Advisory Services (FAS) was engaged in January 2024 to conduct an independent review of Fairfax County Retirement Systems' (FCRS) Uniformed Retirement System's (URS) governance, policies, and operations and identify opportunities for improvement; the final report was submitted in October 2024.
- The scope of the review includes seven primary areas:
    1. Governance Structure
    2. By-laws, Charters, and Policies
    3. Investment Policies and Processes
    4. Board Meetings and Operations
    5. Powers Reserved for the Board and Delegations
    6. Reporting and Board Oversight
    7. Board Interactions with Staff.

Process

- In conducting our governance review we:
  - Reviewed and analyzed current URS charters, governance policies, investment policy statements, and practices and compared to peers.
  - Designed and administered a Self-Assessment Survey and received responses from nine of ten trustees and four executives.
  - Developed a URS InGov® governance peer benchmarking profile.
  - Developed a custom peer benchmarking analysis to compare URS with similar scale county and municipal public retirement systems in the U.S. with respect to the overall operating model.
  - Developed preliminary recommendations that were shared with the trustees and staff; four trustees and the Chief Investment Officer provided feedback.
  - Developed a draft final report with findings and recommendations and verified with the Executive Director and Chief Investment Officer.
  - Finalized the final report and submitted to the URS Board of Trustees.

Overall Findings and Recommendations

Summary of Findings

- There is a lack of formal Board policies and formalized recordkeeping in many areas.
- The Board could operate more efficiently, use trustee and staff time more effectively, and improve system oversight.
- The Board receives independent advice from its investment consultant.

Summary of Recommendations

- Develop a comprehensive Board Governance Policy Manual.
- Revise Board operations and reporting to better utilize trustee and staff time.
- Improve independent reassurance and internal control oversight and better manage risk.

Overall Findings and Recommendations

- Although URS is generally well run, as with any organization, improvements can always be made.
- We made 63 recommendations across the seven areas in scope.
- The following slides summarize our findings and recommendations for improvement.

1. Governance Structure

- It is unclear whether the URS Board operates under the prudent person fiduciary standard or a prudent expert fiduciary standard; the County should clarify the standard.
- FCRS is an outlier with respect to the Executive Director reporting to the County rather than the Boards; the Boards should work with the County to develop a clear description of each Board's role in oversight of the retirement system.
- No URS trustees are required to have experience or qualifications in finance and investments, while most peers require 1-4 trustees with investment experience; URS should work with the County to gradually improve the level of financial and investment expertise on the Board.
- The County should also assist in increasing Board diversity through its trustee appointments.
- The Board should work with the County to pre-authorize selection and engagement of independent external counsel when there are conflicts.

2. By-laws, Charters and Policies

- Develop a new Board Governance Policy Manual (GPM) that builds upon the current URS by-laws, the County Code, and existing URS Board policies to provide a single reference source for trustees.
- Work with the County to clarify and document the URS Board's role in providing direction to Internal Audit activities and document it in an Internal Audit Charter.
- Develop new URS Board policies where there are gaps:
  - Confidentiality
  - External communications by Board members
  - Board self-assessment
  - Expense reimbursement
  - Gifts and loans
  - Indemnification and insurance
  - Procurement
  - Evaluation of direct reports
  - Insider trading

3. Investment Policies and Processes

- Conduct an asset-liability study at least every five years to comply with the Investment Policy Statement (last conducted in 2015).
- The IPS should be updated to reflect new policies (or in some cases, document existing practices) and to clarify and address gaps.
- Evaluate the Board's position on ESG policy and formally adopt or reject it.
- Leverage investment consultant relationship for additional services and research including portfolio stress testing, risk assessment, liquidity analysis, asset class reviews, enhanced investment performance analytics, private markets pacing plans, etc.
- Consider adding to investment staff to enhance investment manager due diligence and monitoring capacity.
- Eliminate finalist investment manager presentations to the Board.
- Establish an appropriate limit to the size of any delegated follow-on private market investments.

3. Investment Policies and Processes (cont'd)

- Provide manager performance exception reports highlighting out-of-tolerance performance limits as set by the Board.
- Perform regular liquidity analysis and portfolio stress testing to assess resilience under adverse market conditions.
- Develop back and middle office policies that address gaps in areas of soft dollars, broker dealer selection, etc.
- Develop an Investment Manual documenting all investment standards, guidelines, processes, and policies for Staff and Board reference.
- Create an annual Investment Calendar to outline the scheduled timing for regular reviews of asset classes, investment pipeline, pacing plan, watchlist action items, and other key activities.

4. Board Meetings and Operations

- Consider moving to a quarterly (or bi-monthly) Board meeting cadence and forming committees (e.g., Audit, Disability, Investment) to utilize Board time more effectively.
- Conduct a self-evaluation of the Board focused on investment and governance oversight.
- Have an annual board retreat to discuss strategy, governance, asset-liability management, and other major topics, as well as potential continuing education.
- Implement improvements in Board book materials such as:
  - Improve discipline in vetting new initiatives through a consistently applied Critical Issues and Options summary; and
  - Use of dashboards, combined with exception reporting.
- Livestream board meetings or make video recordings publicly available on the website for a limited time.
- Provide an annual update to the County Board of Supervisors to keep them informed about the plan's performance.

4. Board Meetings and Operations (cont'd)

- The Executive Director should ensure that the Chair and Vice Chair are appropriately consulted in advance when setting board meeting agendas.
- Develop a multi-year strategic agenda and calendar that identifies key strategy and policy decisions and their upcoming timing.
- Trustee training improvements could include:
  - Ethics training as a standing annual item;
  - Increased frequency of off-site training for all three FCRS boards; and
  - Trustees reporting back after attending external training sessions.

5. Powers Reserved for the Board and Delegations

- Review documentation of powers reserved for the Board and delegations to staff and refine and clarify, as appropriate.
- Consider delegation of approval/denial of disability claims to staff, with the Board hearing only appeals; also consider forming a Disability Committee of the Board.
- Consider delegating review of administrative rules to staff, with final changes approved by the Board.
- Consider forming a joint Committee with the PORS and ERS Boards to potentially:
  - Share oversight of audit, risk, and benefits administration;
  - Provide input to the County CFO regarding Executive Director evaluation, compensation, and succession planning;
  - Identify common continuing education needs across the three systems; and
  - Oversee the development of more frequent common training sessions.

6. Reporting and Board Oversight

- Utilize dashboards for summary reporting to supplement exception reporting.
- Periodically charter a review of the fund's ability to meet long-term actuarial assumptions, including stress testing (Agilis has been recently retained to perform this review.)
- Enhance quarterly investment performance reporting with executive summaries, additional analyses, e.g., private market performance and management fee schedules.
- Develop policies for risk management and compliance.
- Consider establishing an Enterprise Risk Officer role, reporting to the Executive Director, responsible for risk oversight across the ERS, PORS, and URS portfolios as well as FCRS administrative operations.
- FCRS should have an individual with responsibility for compliance activities and to develop a compliance plan; this could potentially be combined with the Enterprise Risk Officer role.
- Participate in periodic (e.g., annual, biennial) benefits administration and investment performance and cost benchmarking.

7. Board Interactions with Staff

- A formal process should be developed to obtain annual Board input regarding the performance of the Executive Director and the Chief Investment Officer.

Next Steps

- The URS Board should discuss the recommendations and:
  - Determine which ones they support and wish to pursue.
  - With the ED and CIO, establish priorities and expected timelines for implementation.
  - Assign responsibility for implementation.
- Some of the recommendations will require collaboration with the County to implement.
- Most recommendations, even those that are addressed to the Board, will require staff support to complete.

Reasonable Reassurance

- This evaluation was a governance review and not a forensic investigation, a comprehensive compliance audit nor an audit of financial statements.
- Our review was intended to provide reasonable, but not absolute, reassurance on matters within scope of the project as addressed in the final report; however, a review of this nature cannot serve as a guarantee regarding past, current or future instances of fraud, malfeasance, compliance or performance.
- Our work product is subject to the accuracy of data and information in the public domain or provided by the client and its agents, including information received in interviews and due diligence activities.
- The scope of the project did not include independent verification or background checks of employees, service providers, third parties or accuracy of such data or information.