Public Retirement System Governance and Board Composition

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Public retirement system governance pertains to the systems and processes that comprise oversight of retirement benefits and assets held in trust for employees of state and local government.

Public Retirement System Governance Actors

- Legislature
- Governor
- Retirement board
- External investment agencies (where applicable)
- Retirement system management

- *The focus of this presentation is on the retirement board and external investment entities*

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Public Pension Governance

Overview of Public Pension Plan Governance

November 2019

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Although often overlooked or misunderstood, governance–defined as the systems and processes that comprise the oversight and control of an organization–plays an important role in the performance of a state or local government retirement system. Public retirement systems are established under state statutes, local ordinances, or both, and subject to fiduciary, investment, and administrative laws, which both grant authority to, and place restrictions on, entities responsible for one or more key areas of plan governance. This overview is intended to summarize the laws and rules that govern public plans, and the range of entities typically responsible for them. Common law trust laws, as well as the prudence and fiduciary standards required by them, also govern public pensions. Because every public retirement system and pension plan, including its governance structure, is unique, the description provided in this introduction is intended to illustrate typical arrangements and will not apply to every state, system and plan. Subsequent publications will address some of these unique or atypical governance arrangements.

Key Takeaways

- Governance of public retirement systems is typically vested with a range of entities; those with a primary role include a legislative body, chief executive, public pension board of trustees, and key staff. An oversight committee or agency and other entities may also have a role.
- Key areas of retirement system governance—setting benefit levels, design and funding—in most cases are not delegated to public retirement system boards or staff, but rather are the responsibility of elected legislative bodies and the chief executive.
- Public retirement system boards and staff typically face restrictions in one or more key areas of governance that typically is assigned to them, including asset management, personnel policies, and the use of service providers.
- Every public retirement system is unique and systems should be measured in the context of their individual governance framework.

The Role of Legislative Bodies and Chief Executives

Two areas with a significant effect on the cost of a public pension plan and its funding level are the plan's design and financing structure.

A pension plan's design refers to the framework of the plan, defined by such characteristics as the age of eligibility to qualify for benefits, the rate at which benefits accrue, vesting requirements, required contributions from employers and employees; and others. A pension plan's design is the most important factor in the plan's cost, and normally is the responsibility of policymakers: state legislatures, city councils, and county commissions, etc. Recommendations for benefit design can also come from a variety of stakeholders, including governors, mayors, and other constituent group representatives.

Typical Responsibilities
Legislative Body
- Establishes retirement plan design
- Approves pension plan funding
- Establishes retirement system board structure
- Approves some or all retirement system board members

Public Pension Governance Stakeholder Roles

May 2020

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Public retirement system governance pertains to the systems and processes that comprise oversight of retirement benefits for employees of state and local government. The governing structure in the U.S., manifest chiefly in the U.S. Constitution, 50 state constitutions, and state laws, is designed to disperse power among different groups and individuals so as to prevent one group from accumulating excessive authority in one area. The principle of dispersed power holds true with public pensions: generally, no one group or person has complete authority over public retirement systems. Rather, as described below, different groups and individuals have different levels and types of responsibility to govern the retirement system and its chief components: the plan, i.e., the benefit structure and how it's paid for, and the fund—the assets and how they're managed and invested.

This paper follows and builds on the NASRA publication, *Overview of Public Pension Plan Governance*, first published in November 2019, by focusing on the respective role certain groups and individuals—the legislature, the governor, retirement system boards, and retirement system staff—play in public pension plan governance.

Plan Sponsor Role: The Legislature

The legislature (or city council or other elected body responsible for establishing laws within the jurisdiction) typically is the main policymaking authority over the most consequential governance elements of a public retirement system. In nearly all cases, the legislature (or other governing legislative body) is responsible for sponsoring, or establishing, the retirement system and the benefits the system administers, and for determining how the benefits are funded. These are the most substantive elements affecting the overall cost and funding condition of a pension plan.

Not every legislature, however, is equal in terms of its governance authority. For example, this paper's section on the role of public retirement system boards identifies examples of systems whose board has been given authority—by the legislature—to adjust benefit levels, contribution rates, or both. Other notable exceptions to legislative control over the primary elements of public pension governance are legal protections, which take the form of explicit constitutional protections, contractual protections, and case law. These protections limit the ability of the legislature to determine or adjust benefits or to fund the plan.

Perhaps the clearest example of a state constitutional provision limiting a legislature's control is that of the Illinois State Constitution:

> Membership in any pension or retirement system of the State, any unit of local government, or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.[1]

Established as part of a state constitutional convention in 1970, this provision has been cited repeatedly in recent years by the Illinois Supreme Court to justify rejecting efforts by the state legislature to reduce pension benefits for public workers in the state.

Other states have different forms of constitutional protections of pension benefits for public employees; one common form is contractual protection pursuant to either the Contracts Clause of the U.S. Constitution or similar provisions in

[1] Illinois Constitution, Article XIII, §5

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Fiduciaries and Fiduciary Duty

- Board members and others who oversee retirement system operations and investment functions are *fiduciaries:* someone legally assigned or authorized to manage or oversee property on behalf of another person or group.
- **Two core fiduciary duties:**
- **Duty of Loyalty:** A retirement system trustee must operate for the exclusive benefit of plan participants. Trustees must be impartial among groups of plan participants and do not represent a particular constituency or interest group. Trustee decisions should not be motivated by pursuing personal views of social or political issues.
- **Duty of Prudence/Duty of Care:** A retirement system trustee must act in a way that a reasonable or prudent person would under similar circumstances or in the conduct of their own affairs.

Government Finance Officers Association, Best Practice:
Governance of Public Employee Post-Retirement Benefits Systems

Retirement Board Size and Composition

Size

- A public retirement board "should be neither so large as to be unwieldy nor so small that it runs the risk of being led by a narrowly focused group of decision makers ... Optimal board size depends on the size and complexity of the system."

Composition

- "A board should include members who have a diverse mix of skills, competencies, and behaviors, including leadership, teamwork, communication, planning and organizational abilities, and knowledge of sound decision-making principles. ... This may include plan participants and retirees, citizens of the governmental unit, and officers of the plan sponsor, as well as independent directors. This assures balanced deliberations and decision making."

Government Finance Officers Association, Best Practice:
Governance of Public Employee Post-Retirement Benefits Systems

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State Retirement Board Governance Models

1. Single board oversees both admin/liabilities and assets
   - This is the most common model and is the one used by New Mexico PERA and New Mexico ERB
2. Separate entities oversee admin/liabilities and assets
   - 15 states use this model
3. Board oversees admin/liabilities, sole trustee oversees assets
   - Three states use this model
4. No admin/liabilities board; board oversees assets
   - Three states use this model

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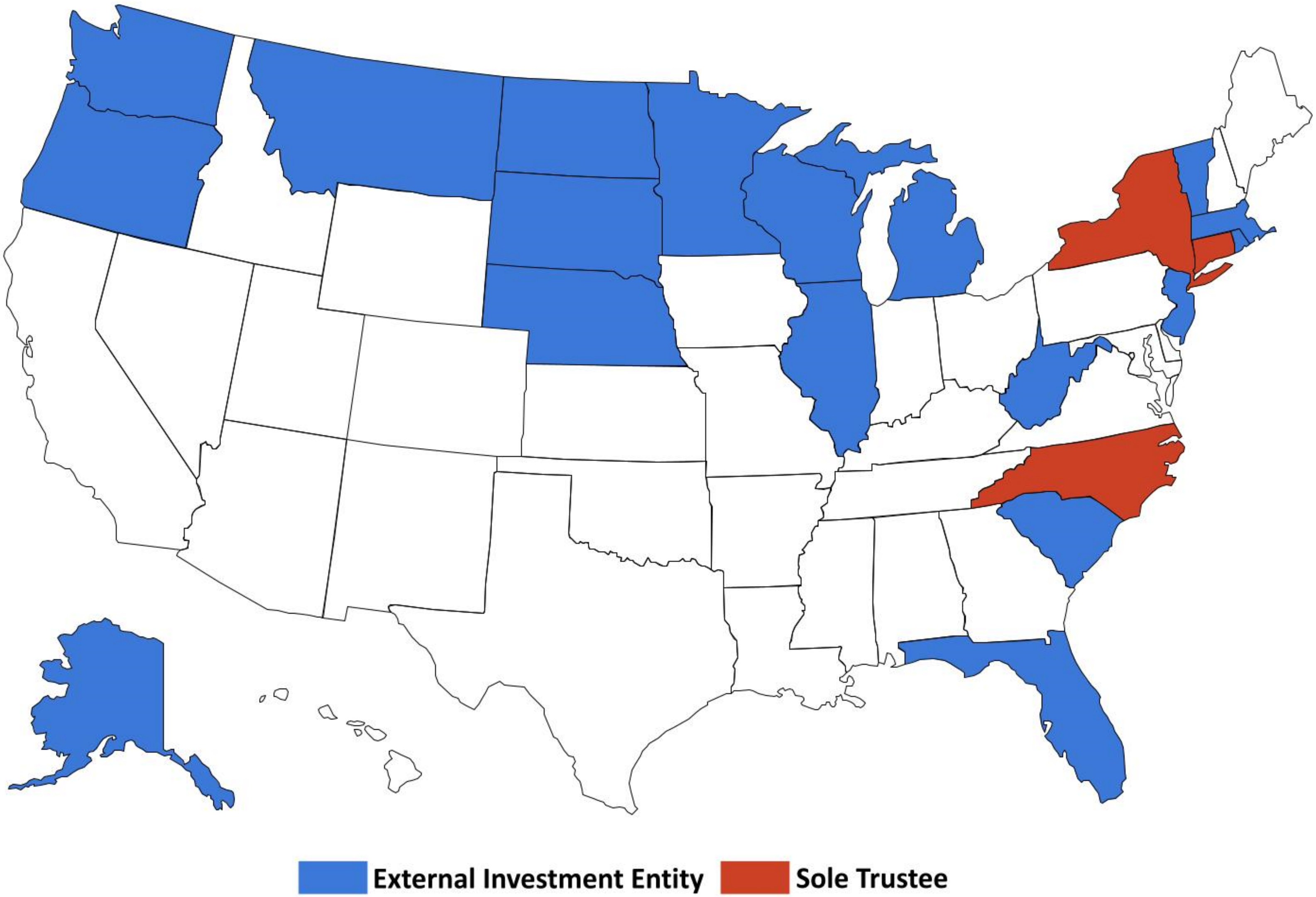
Public Pension Fund Investment Oversight



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Who Serves on Public Retirement Boards?

- Plan participants: active and retired
- Members of the general public
- Ex-officio members

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Three Ways to Get on the Board

- **Appointed**
  - In most cases by the governor; also by the state treasurer, legislator(s), and other entities, such as a labor union or board of education. Some appointed to “represent” certain groups, such as state workers, firefighters, or employers.
- **Elected**
  - By active participants, retirees, or both. In some cases, elected by certain groups of actives, such as teachers or firefighters. Some elected only by employer members.
- **Ex-officio**
  - On the board by virtue of their position
  - Some ex-officio members have voting rights; others do not

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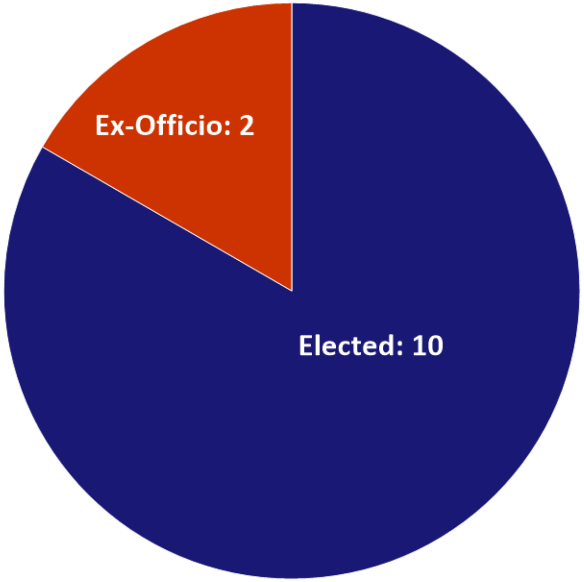
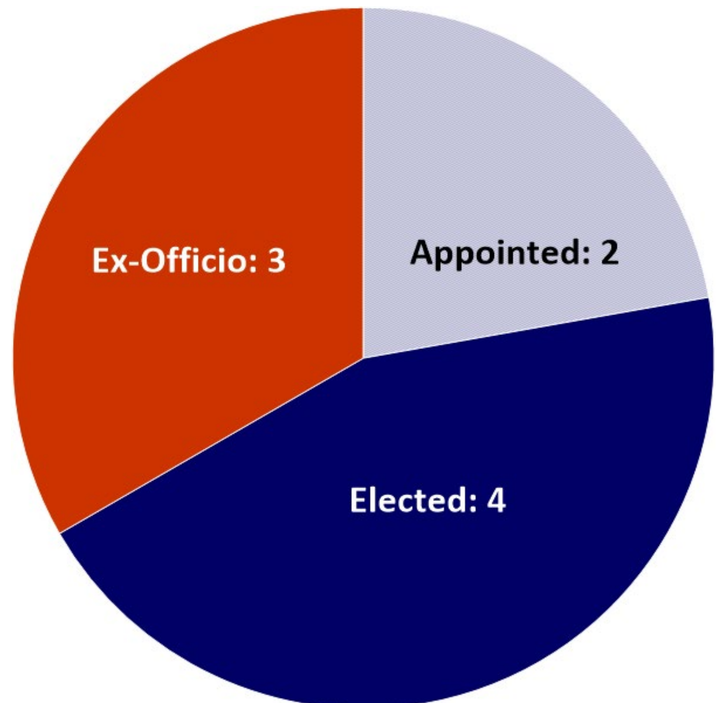
New Mexico PERA
Who Serves on the Board and How Do They Get There?



- Elected: Four state workers; four municipal workers, including at least one county worker; and two retired members
- Ex-officio: Secretary of State and State Treasurer
- No requirements for knowledge or experience

New Mexico ERB
Who Serves on the Board and How Do They Get There?

- One each elected by:
  - NM Association of Educational Retirees
  - National Education Association of NM
  - NM members of the American Association of University Professors
  - American Federation of Teachers NM
- Two appointed by the governor:
  - Must "have a background in investments, finance or pension fund administration."
- Ex-officio:
  - Secretary of Education, Secretary of Higher Education, State Treasurer (or their designees)



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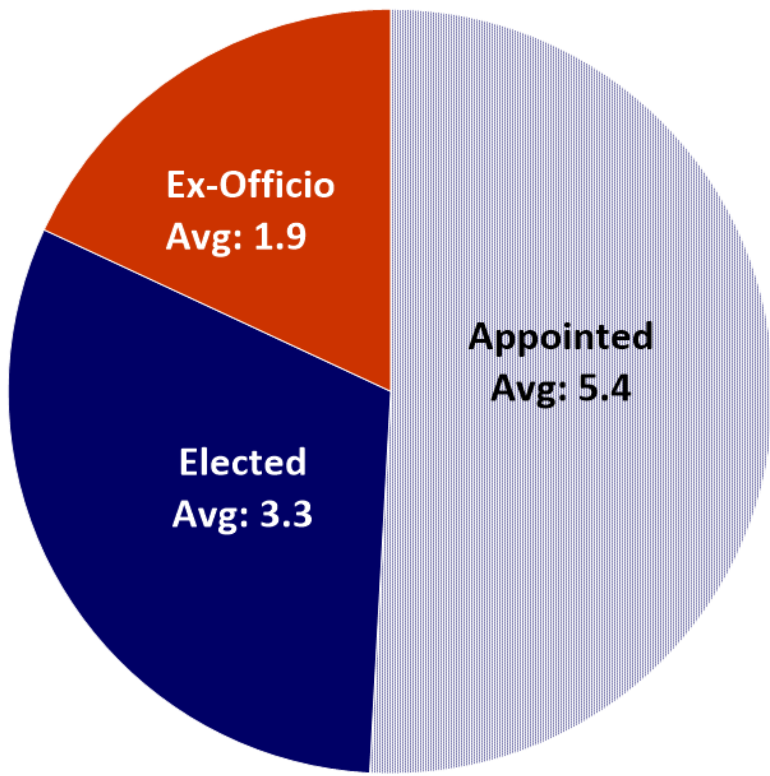
State Retirement Boards That Oversee Admin/Liabilities and Assets
How They Get There

Average Board Composition of 59 Statewide Public Retirement Systems



Average size: 10.5 members

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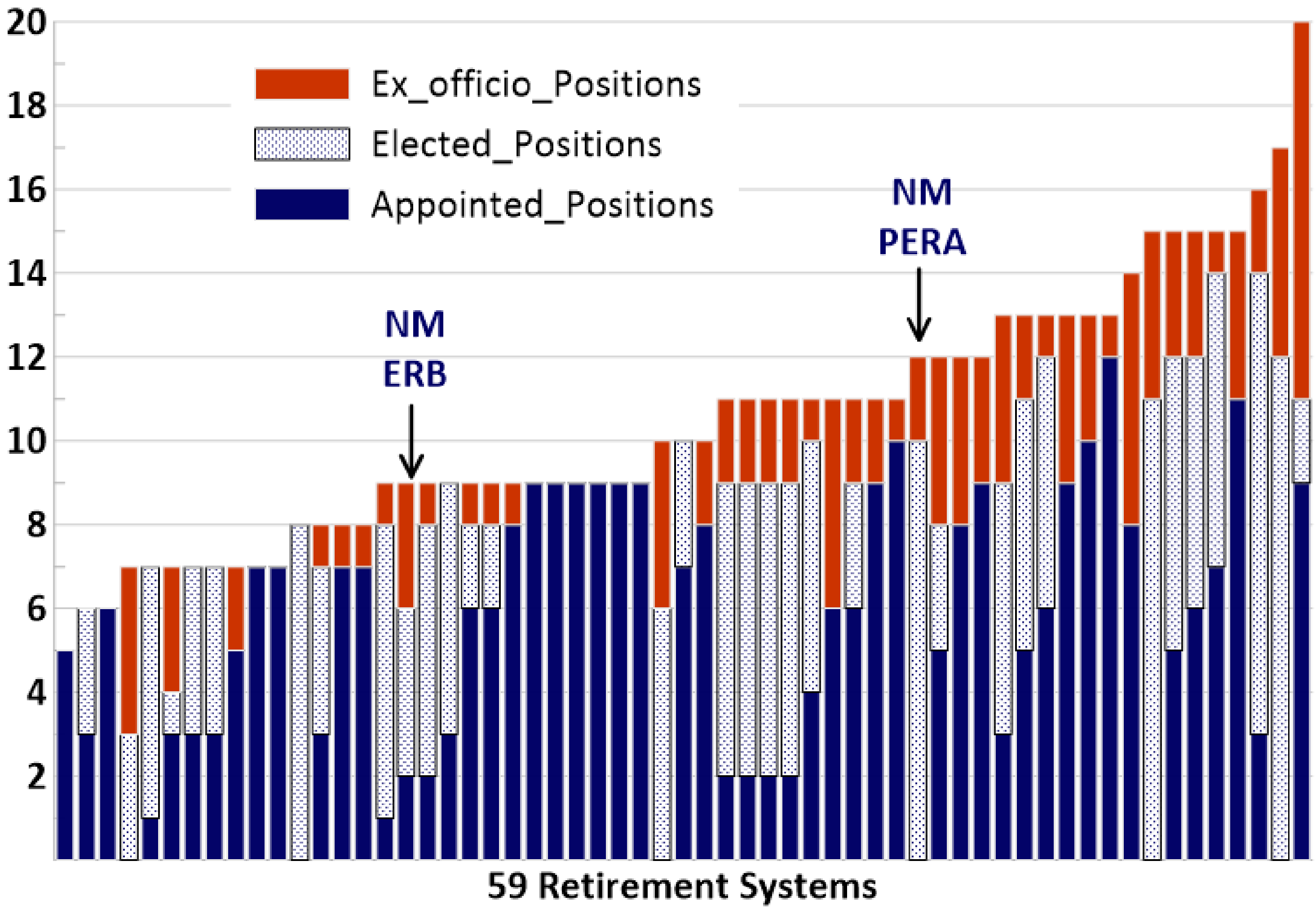
State Retirement Boards That Oversee Admin/Liabilities and Assets How They Get There



Boards That Oversee Admin/Liabilities and Assets

- Of 59 systems in our sample that oversee both admin/liabilities and assets, NM PERA and six others have no appointed positions.
- In two of the other six systems, several trustees are elected by employers, not fellow employees.
- Membership at the other six systems with no appointed trustees is limited to single employee groups, such as state employees, municipal employees, teachers, or highway workers.
- Other than NM PERA, every statewide system in our data set with a diverse membership base—state and local, general employees and public safety, etc.—has at least one appointed trustee.

Required Qualifications

- Of systems that oversee admin/liabilities and assets (like ERB and PERA), one-half require specific knowledge or experience to serve on the board.
- A correlation between trustee knowledge and experience and outcomes has not been definitively established.
- The challenge in establishing a correlation is that every retirement system and pension plan is unique, with their own objectives. Objective comparisons of outcomes among public retirement systems are difficult to make.
- Anecdotal evidence and logic suggest that having trustees with training and experience in fields pertinent to retirement systems is more likely to produce better outcomes.

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Boards That Oversee Admin/Liabilities and Assets
Required Knowledge and Experience

Arizona State Retirement System: All nine trustees are appointed. Four members must have at least 10 years' substantial experience as any one or a combination of the following:

1. A portfolio manager acting in a fiduciary capacity.
2. A securities analyst.
3. An employee or principal of a trust institution, investment organization or endowment fund acting in a management or investment-related capacity.
4. A chartered financial analyst in good standing as determined by the CFA institute.
5. A professor at the university level teaching economics or investment related subjects.
6. An economist.
7. Any other professional engaged in the field of public or private finances.

Each member who represents an ASRS member group shall have not less than five years of administrative management experience.

Arizona Revised Statutes § 38-713

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Boards That Oversee Admin/Liabilities and Assets Required Knowledge and Experience

- **Colorado PERA**: Three trustees appointed by the governor who are not members of the association must have significant experience and competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis.

  Colorado Revised Statutes § 24-51-203

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Boards That Oversee Admin/Liabilities and Assets Ex-Officio Positions

Approximately three-fourths of systems using this model have at least one ex-officio position. Typical ex-officio positions include state officers whose scope of responsibility relates to retirement system management, such as:

- Treasurer
- Auditor
- Finance director
- Budget director
- Human resources officer
- Education commissioner
- Insurance commissioner
- Banking commissioner

New Mexico PERA is the only state retirement system in the U.S. where the secretary of state serves on a state retirement board as an ex-officio member.

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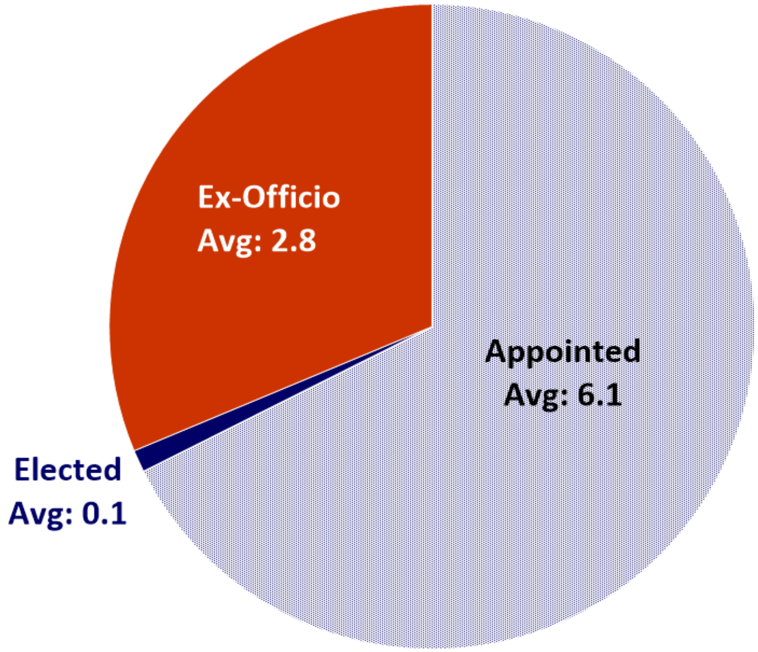
Boards That Oversee Assets Only
How They Get There

Average Composition of 18 Public Pension Investment Agencies



Average size: 8.9 members

Of 18 investment agencies that use this model, one position on one board (Massachusetts) is elected. All other positions are appointed or ex-officio.

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Boards That Oversee Assets Only
Required Knowledge and Experience

- All but one of 18 statewide investment agencies have requirements for knowledge and experience. Two representative examples:

- **Alaska Retirement Management Board**: "The seven trustees appointed by the governor must be professionally credentialed or have recognized competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis."
  Alaska Statutes 37.10.210

- **Nebraska Investment Council**: "The appointed members of the council shall have at least seven years of experience in the field of investment management or analysis or have at least 12 years of experience in the financial management of a public or private organization. There is a preference for members who are appointed to have experience in investment management or analysis."
  Nebraska Revised Statute 72-1238

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Sole Trustees

- Connecticut, New York State (and NYC), and North Carolina have sole trustee models
- These individuals have sole responsibility for making investment decisions regarding pension fund assets
- Each sole trustee is statutorily assigned an investment advisory committee
- Investment advisory committee requirements follows

Connecticut State Treasurer
Investment Advisory Committee

- The membership of the Investment Advisory Council consists of the Secretary of the Office of Policy and Management (ex-officio), State Treasurer (ex-officio), five public members to be appointed by the Governor and legislative leadership, all of whom shall be experienced in matters relating to investments, three representatives of the teachers' unions and two representatives of the state employees' unions.

Connecticut General Statutes - Sec. 3-13b

New York State Comptroller
Investment Advisory Committee

- "To assist in the management of the monies of the common retirement fund, the comptroller shall appoint an investment advisory committee consisting of not less than seven members who shall serve for his term of office. …
- Each member of the committee shall be experienced in the field of investments and shall have served, or shall be serving, as a senior officer or member of the board of an insurance company, banking corporation or other financial or investment organization authorized to do business in the state of New York.
- The committee shall advise the comptroller on investment policies relating to the monies of the common retirement fund and shall review, from time to time, the investment portfolio of the fund and make such recommendations as may be deemed necessary."

N.Y. Retire. & Soc. Sec. Law § 423

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North Carolina State Treasurer
Investment Advisory Committee

- "The State Treasurer shall appoint an Investment Advisory Committee, which shall consist of seven members: the State Treasurer, who shall be chairman ex officio; two members selected from among the members of the boards of trustees of the Retirement Systems; and four members selected from the general public.
- All appointed members must have experience in areas relevant to the administration of a large, diversified investment program, including, but not limited to, investment management, securities law, real estate development, or absolute return strategies."

NC General Statutes - Chapter 147 Article 69.2

Boards That Oversee Admin/Liabilities Only

- Relatively larger representation of plan participants—active or retired—than boards that oversee both admin/liabilities and assets, and that oversee assets only
- Larger percentage of board members are appointed relative to those that oversee both admin/liabilities and assets

Boards That Oversee Admin/Liabilities Only
Required Knowledge and Experience

- **West Virginia Consolidated Public Retirement Board**: "All appointees to the board shall have recognized competence or significant experience in pension management or administration, actuarial analysis, institutional management, or accounting. One trustee shall be an attorney experienced in finance and pension matters and one trustee shall be a certified public accountant. Each member of the board must complete annual fiduciary training."

  W.V. Code §5-10D-1.

- **Nebraska PERS**: "Two appointed members shall have at least 10 years of experience in the management of a public or private organization or have at least 5 years of experience in the field of actuarial analysis or the administration of an employee benefit plan.

  Nebraska Revised Statutes §84-15-01

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Thank you.

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