

Fiduciary Performance Audit of the Highway Patrol Retirement System

Conducted on Behalf of the
Ohio Retirement Study Council

September 14, 2023



Introductions

FAS team members:

- Randy Miller, co-project manager
- Steve Ross, co-project manager
- Mike Albert, investment operations expert
- Steve Case, investment expert
- Rick Funston, FAS founder and governance and risk expert
- Michael Gold, investment operations expert
- Keith Johnson, legal counsel
- Susan Lau, investment expert and former CIO

Overview

- The Funston Advisory Services (FAS) team was selected to conduct the fiduciary performance audit of HPRS through a competitive RFP process in December 2022; the final report was submitted in May 2023.
- We reviewed six major areas, as specified in the RFP:
 1. Board Governance and Administration;
 2. Organizational Structure and Staffing;
 3. Investment Policy and Oversight;
 4. Legal Compliance;
 5. Risk Management and Controls; and
 6. IT Operations.

Process

- Our fiduciary audit approach and activities included:
 - Review of HPRS policies, procedures, and reports;
 - Interviews with ten trustees and four HPRS executives, and seven outside service providers;
 - Board Fiduciary Priorities Survey with participation by ten trustees and four HPRS executives;
 - Use of our proprietary InGov[®] public retirement system peer benchmarking data;
 - Numerous follow-up interviews and discussions with executives; and
 - Periodic status discussions with ORSC staff.

Overall Findings

- The HPRS Board of Trustees appears to be satisfactorily fulfilling its fiduciary duties (loyalty, prudence, staying informed, diversifying assets, controlling costs, compliance with laws and co-fiduciary duties).
- The HPRS Board has the powers or authorities needed to fulfill its fiduciary duties and functions effectively and efficiently.
- As a small state public retirement system, HPRS has a staff of only eight employees and relies heavily on external advisors and service providers; this is consistent with most peer state public retirement systems of similar scale.
- The investment program is managed effectively, and the external financial advisor is highly qualified.
- Pension administration functions effectively and there is a high level of member and retiree satisfaction.

Overall Findings

- Although HPRS is generally well run and has quality advisors, as with any organization, improvements can always be made.
- We made over 110 recommendations across the six areas in scope.
- The following slides highlight:
 - The most important conclusions and opportunities for improvement in each area; and
 - Those recommendations that require legislative support.

1. Board Governance and Administration

- Although trustee education has improved, HPRS should develop a Board education policy that strengthens its continuing education program, including expanding the Ohio joint trustee training program, if possible (R1.1.1-2).
- The Board should develop additional policies for Trustee referrals (R1.2.1); manager and service provider compliance (R1.6.1); and trading on material, non-public information (R1.6.2).
- The HPRS Board committees should livestream the public sessions of their meetings (R1.4.1) and provide public access to Board meeting materials (R1.4.2-3).
- The Audit Committee should be more proactive and meet with auditors without staff present (R1.4.5-6).
- The Board should develop a formal succession plan for the Executive Director (R1.7.1).
- HPRS should enhance its website and stakeholder communications (R1.9.1).

2. Organizational Structure and Staffing

- Members and retirees are satisfied with the services provided by HPRS.
- HPRS administers comprehensive member surveys every three years and has acted upon the feedback obtained; however, surveying could be improved (R2.2.1).
- Staffing is stable and compensation appears to be adequate.
- Staff are cross trained and have appropriate training opportunities.
- HPRS could consider adopting a proficiency-based human resources model, vs. a position-based model, to improve focus on skills and capabilities development (R2.1.1-2, R2.3.1, R2.4.1-2).

3. Investment Policy and Oversight

- The Investment Committee (IC) leverages the experience and qualifications of the appointed investment experts, as well as elected trustees with investment experience.
- The Board follows prevailing practices in the development of their Investment Policy Statement (IPS); it should develop a separate Statement of Investment Beliefs (SIB) (R3.1.1.1).
- The Board has developed a policy that effectively determines allocations to the Health Care plan and to COLA payments; this should be documented and included in the IPS (R3.1.2.3).
- The roles and responsibilities adopted for the Board, Investment Committee, Chief Investment Officer and consultant are appropriate and consistent with other plans of this size.
- Investment risk reporting to the Board should be enhanced, and the Board should consider a broader set of risk factors in policy setting and program monitoring (R3.3.1.1-6, R3.3.2.1).
- HPRS custodial services are adequate and function well; with limited staffing at HPRS, the role of the Treasurer of State as custodian is beneficial, providing the RFP process “service” and the oversight framework to manage the custodial working relationship. This process should be documented in a Memorandum of Understanding to ensure continuity.

4. Legal Compliance

- HPRS legal functions appear to be reasonably staffed and are consistent with similar size peers.
- HPRS should formalize tax compliance procedures to obtain periodic written confirmation from tax counsel that the plan qualifies for favorable tax treatment (R4.1.1).
- HPRS should assign compliance monitoring and reporting to a staff member and task a Board committee with compliance oversight for the board (R4.3.1).
- Legal and investment staff should consider use of investment, operational and legal due diligence closing checklists and file documentation standards (R4.4.1).
- HPRS should seek legislative authority to select external legal counsel, or engage with the Attorney General about formalizing a Memorandum of Understanding that provides for HPRS to select outside legal counsel (R4.2.1).

5. Risk Management and Controls

- Overall, HPRS is a high performing organization with a strong tone at the top, middle and bottom.
- Governance, risk and compliance are taken very seriously and commitment to improvement is evident throughout.
- Accounting and audit procedures are generally consistent with prevailing practices.
- Internal audit, which is outsourced to Summit County, appears to function effectively, using a five-year rotation of audit areas; however, there are opportunities for improvement, particularly an update to the risk assessment (R5.1.1, R5.4.1-5).
- HPRS procurement policies and processes are fundamentally sound.

6. IT Operations

- In general, HPRS has adequate information systems to support its operations, although there are many manual processes.
- Although IT support has been competent and reliable, reliance on a sole consultant for IT operations poses a significant risk (R6.1.1).
- HPRS intends to update its website and pension administration system over the next few years, and potentially also its financial systems.
- HPRS should encrypt its sensitive information, including its membership databases (R6.7.1) and improve its security monitoring (R6.10.1).
- HPRS should develop a Business Continuity Plan to address on-going service to active and retired members in the event of a business disruption (R6.8.3).
- HPRS should assign responsibility for data privacy and update its privacy policies (R6.10.3).

Summary

- Overall, HPRS operates effectively, staff are capable, and members and retirees are satisfied.
- HPRS Board oversight appears prudent, and delegations are functioning well.
- HPRS relies on a network of competent advisors and service providers to complement a small internal staff.
- HPRS leadership has been receptive to our recommendations and has already begun to implement some of them.
- The legislature should consider changes to statutes related to hiring of external legal counsel (R4.2.1).

Reasonable Reassurance

- This evaluation was a fiduciary 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.