



Comprehensive Review
of the
Investment Program

City of Phoenix Employees' Retirement System

Discussion Guide

August 19, 2009

Scope of Review

- In the report we reviewed the following items related to the COPERS investment portfolio:
 - Legal Authority – including the laws that create and govern COPERS
 - Governance – including COPERS' internal oversight policies and certain practices
 - Investment Strategy – including investment related policies, portfolio structure, and fees
 - Investment Manager Selection and Evaluation – including due diligence policies and practices
 - Investment Performance Reporting Process – including the content and frequency of reports

Overall Findings

- COPERS is fundamentally sound in the areas that we reviewed.
- We were favorably impressed by the dedication and insight of the Board, and the caliber of the COPERS' and City Auditor Department's staffs.
- COPERS has a high level of sophistication in operations and a focus on maintaining excellence in the areas covered by this review.
- COPERS already follows many best practices.
- We did not discover any material shortcomings, and the System's sound governance structure and investment program reflect positively on the COPERS Board and staff.
- The recommendations we present will help to further strengthen the organization and, in some instances, convert common practices to best practice.

Recommendations and Considerations

- Recommendations are our advice about what changes will improve current practices or policies.
- We encourage the Board to address the recommendations and either formally accept or reject them based upon what is in the sole interest of the System.
- Considerations are our suggestions of alternative ways of operating.
- None of the recommendations addressed “critical” errors, breaches of fiduciary duty, or major problems within the organization.
- The Board has the ultimate authority to prioritize, accept, modify, and reject any and all recommendations based on COPERS’ needs and resources.

Legal Authority

- The overall size and term limits of the COPERS Board are appropriate and do not appear to pose any problems.
- The number of ex-officio members on the Board is relatively high, but this is not a problem since all appear to understand their fiduciary duty of undivided loyalty.
- The retirement system employs experts both on staff and as outside service providers consistent with the duty of prudence required of fiduciaries.
- As the investment portfolio becomes more complex, the Board will need to ensure that its level of expertise increases as well.
- The Charter does not clearly define the fiduciary duties which apply to the COPERS Board in carrying out its mission.
- Investment restrictions could possibly impair the ability of the COPERS Board to prudently invest and diversify the assets of the System because the opportunity set is narrowed.
- The COPERS Board and staff should have control over the selection of legal counsel, their scope of work, and fees for the services rendered.
- The Board's delegation of authority is working well.
- It may benefit the Board to discuss available fiduciary liability protections.

Governance

- Policy No. 3 sets a good foundation for the governance of the System; however, it could be enhanced to better reflect the full scope of the Board's responsibilities.
- The roles of the Board officers set forth in Policy No. 3 are moderately representative of the actual roles; however, certain functions that the Chair currently fulfills are not documented.
- COPERS has addressed the functions, procedures, meeting frequency, and composition of the Investment Committee and the Charter Amendments/Policies & Procedures Committee. Complete Charters could be developed for all Committees.
- An audit committee, composed of members with the same fiduciary responsibilities to the trust, would assist the Board in fulfilling its oversight function.
- The frequency and length of Board meetings are appropriate for the agenda items covered. Board meeting material is comprehensive, valuable to the Trustees, and provided in a timely manner.
- COPERS is adhering to best practices by having new Trustee orientation and ongoing education. Adding a requirement for annual fiduciary training would further enhance the policy.
- The City Ethics Handbook is comprehensive -- it covers most of the major areas we usually recommend be addressed in ethics policies.
- The travel and expense regulation is appropriate.

Governance

- COPERS has many good informal policies in place and follows sound business practices.
- Evaluation of additional governance policies, and the development of a comprehensive governance manual may benefit COPERS.
- COPERS would benefit from “rounding out” its governance policies to include guidance about policy compliance responsibilities.
- The duties and responsibilities of the Retirement Administrator are reasonable and comparable to those of top administrators of other similarly sized public retirement systems. The evaluation process could be enhanced.
- The Investment Manager position fulfills many important oversight and monitoring activities. The support provided by the Investment Manager (and the Retirement Administrator) meets the Board’s needs at this time.
- COPERS has in effect outsourced its internal audit function to the City Auditor. The City Auditor Department has made significant efforts to research the auditing needs of COPERS and to follow the best established practices for audits of public retirement systems.
- COPERS’ governance would be enhanced by further developing its internal controls through a comprehensive risk assessment with input from the Board.

Investment Strategy

- COPERS is conducting actuarial valuations and experience studies in accordance with industry standards. COPERS has had an actuarial audit, which is a best practice.
- COPERS' investment policy reflects best practice in a number of areas; however, the format and content could be enhanced.
- COPERS' proxy voting policy is sound and positions each vote to be in the best interest of COPERS.
- While the Board carefully structures and monitors its securities lending program, a formal policy does not exist.
- Developing and adopting a securities litigation policy may be beneficial.
- Brokerage costs are a plan expense and thus need to be monitored. A policy that addresses brokerage and commission recapture would be a benefit to COPERS.
- COPERS' process for determining its asset allocation, and the risk and return characteristics of the fund, has been reasonable. Conducting an asset liability study at this time, however, would be consistent with best practice.

Investment Strategy

- COPERS' target asset allocations are reasonable relative to other public funds.
- The process by which new investment opportunities are identified and evaluated is thorough and prudent. It has worked well for the Board, and both the staff and the investment consultant have taken active roles in facilitating effective decision-making. It would be best for the process to be documented.
- The number and types of managers COPERS employs is reasonable and overall the portfolio is fairly well diversified. The one area that may benefit from further diversification is the fixed income asset class.
- COPERS' custody arrangements, commission recapture program, and securities lending program are reasonably structured, monitored, and priced.
- It may be beneficial to review the securities lending program to determine how a more conservatively managed collateral reinvestment portfolio will affect the amount of securities on loan and the revenue that can be earned for COPERS going forward.
- COPERS' fees are in a reasonable range given the structure and size of the asset base.

Investment Manager Selection and Evaluation

- Although not documented in a written policy, COPERS' manager search and selection process is thorough and prudent.
- COPERS is following best practice by using an "open search" process.
- COPERS' manager monitoring process is also thorough and prudent. The monitoring process is in compliance with best practices, but should be documented in a monitoring policy.

Investment Performance Reporting Process

- COPERS is receiving the investment performance reports it needs to comply with the fiduciary duty to monitor the performance of investment managers.
- The reports are timely, comprehensive, and useful. Overall, they meet best practice standards.
- Including net-of-fee results and risk/return exhibits for the total fund would further improve the performance reports.
- The investment consultant makes quarterly presentations about performance, and provides monthly return reports which the Board leadership and staff find meaningful.
- The market benchmarks established by the Board for the total fund and the individual managers are appropriate.