JOINT REPORT *to the* CONNECTICUT GENERAL ASSEMBLY

Analysis: Best Practices for Municipal Retirement Plans

JULY 2024

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EXECUTIVE SUMMARY

Public Act No. 23-182 made several important revisions to the Connecticut Municipal Employees Retirement System (CMERS). The legislation also called upon municipalities—including those that do not participate in CMERS—to provide the Office of the State Comptroller with information about their retirement plans that could help inform future improvements, both to those plans and to CMERS. The bill directed the State Comptroller, the State Treasurer, and the Secretary of the Office of Policy and Management to review that information and jointly to submit a report that recommends best practices and legislative changes to assist municipal retirement plans[1], summarizes the current governance structures and management arrangements of such plans, and recommends how the state can partner with municipalities to improve the management of such plans.

A total of 110 municipalities provided information pursuant to the statute to the Office of the State Comptroller. This report summarizes the information the Comptroller obtained, outlines best practices and governance structures for municipal retirement plans, and offers recommendations to improve the administration and investment management of these plans.

[1] Municipal retirement plans fall into two main categories: **(1) Defined benefit plans**, which promise employees a guaranteed monthly pension payment based on preset formula accounting for the retiree's salary and length of service and **(2) Defined contribution plans**, which allow employees and employers to contribute to a participant-directed investment account, with the employee bearing the entire investment risk. While the majority of Connecticut municipalities continue to offer defined benefit plans, in the years following the Great Recession, a significant number of towns and cities have transitioned from defined benefit to defined contribution plans.

The Office of the State Comptroller reviewed the information the municipalities provided and the data shows:

- 81 defined benefit plans that were previously offered by government employers in Connecticut have closed, impacting 57 municipalities.
- The average funded ratio of municipal plans is 79.05%, reflecting a range from 34.80% to 128.10%.
- The average employee contribution rate to a defined benefit plan is 5.50%, ranging from 0% to 12%, and the average benefit multiplier is 2.03%, ranging from 1.00% to 3.00%. There is a positive correlation between employee contribution rates and benefit multipliers.
- The average normal retirement age is 61 years, with a range from 45 to 65 years.
- General employee plans differ significantly from plans for public safety employees with respect to features such as contribution rates, benefit multipliers, and the structure of cost-of-living adjustments (COLAs).
- Most municipalities have eliminated guaranteed minimum COLAs from their defined benefit plans.
- About half of defined benefit plans factor overtime into the calculation of a retirement benefit. Most of the plans that have closed included overtime in their calculation.
- Defined contribution plans have an average employee contribution rate of 6.59% and an average employer contribution of 7.12%.

The State Comptroller, State Treasurer, and Secretary of the Office of Policy and Management have developed a series of best practices that are discussed in detail in the last section of this report. They include:

- For municipalities committed to continuing a defined contribution (DC) plan, an option to join a DC plan for municipal employees, administered by the State Comptroller, to which the assets of municipal retirement plans may be transferred to reduce investment and administrative costs.
- For municipalities who offer a defined benefit plan, not already enrolled in MERS, an option to join a new MUNI Trust municipal defined contribution plan, administered by the State Treasurer, to alleviate the burden of investment costs.
- Retirement plans should tailor their governance structures to the specific circumstances relevant to their individual situations. When a board governance structure is chosen, municipalities should consider including board members whose members include representatives of relevant stakeholders, as well as subject matter experts. In addition, fiduciary training and continuing education for members of fiduciary boards should be considered.
- Adopting best practices for investment policies that have previously been promulgated by the State Treasurer, and which are discussed in detail below.

BACKGROUND

2023 Legislative Session

In 2023, state leaders reached a bipartisan agreement to reform certain components of the Connecticut Municipal Employees Retirement System (CMERS). The goal was to create “win-win” adjustments: measures that would reduce the costs borne by municipal employers while adding potential benefits to plan members. These measures included (i) changes to the annual cost-of-living adjustments (COLAs) that simultaneously phased out pension increases which outpace inflation and boosted potential increases when inflation is high; and (ii) the creation of a deferred retirement option plan (DROP) that will allow experienced personnel to accumulate pension benefits by extending their careers.

The Legislature also directed the State Comptroller to collect information about municipal retirement plans within the state and to use that information—in collaboration with the Treasurer and the Secretary of the Office of Policy and Management—to develop "best practices," to recommend legislation that might facilitate those best practices, and to recommend means by which the state can partner with municipalities to improve the management and reduce the costs of municipal plans.

Survey Methodology

To carry out the requirements of the 2023 legislation, the Comptroller's office distributed a survey to towns and cities across Connecticut, requesting information on all retirement plans offered to public employees. The survey requested the following categories of information and included the following questions:

1) Contact information of the respondent.
2) Has your municipality adopted a formal Investment Policy Statement (IPS)?
3) Does your municipality use a third-party advisor or administrator (TPA) to provide management or oversight of your retirement plans?
    a. If Yes, please identify the TPA.
4) Describe your municipality's retirement plan governance structure and oversight.
5) Please list the FY19-FY23 total investment fees paid by your municipality for each plan.
6) For each defined benefit plan offered, please upload the 5 most recent actuarial valuations (excluding CMERS).
   Upload the Summary Plan Documents (SPD) for each applicable plan offered over the last five fiscal years. The response rate for the survey was 65%, with about 63% of the responding towns providing a comprehensive submission containing all the requested information.

OFFICE OF THE STATE COMPTROLLER'S SUMMARY OF MUNICIPAL SURVEY DATA

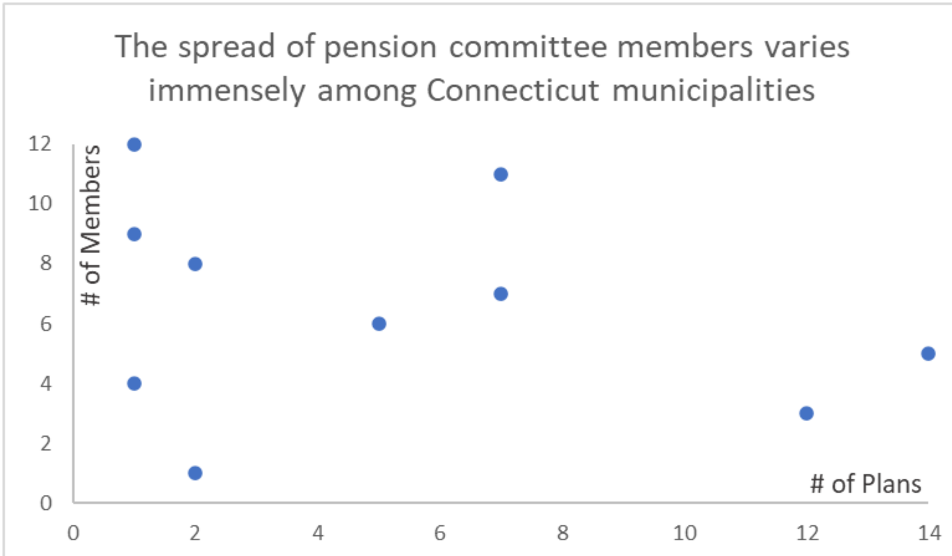
Survey Disclaimer

When reviewing the data and analysis of responses, it is pertinent to emphasize that the sample size is small. The number of comprehensive responses received equated to approximately 41% of municipalities. Combining this with the knowledge that retirement plans should be tailored to the specific circumstances relevant to each municipality, the following findings are not able to provide distinct conclusions, but rather an overview with national research to supplement when necessary.

Municipal Governance Structures

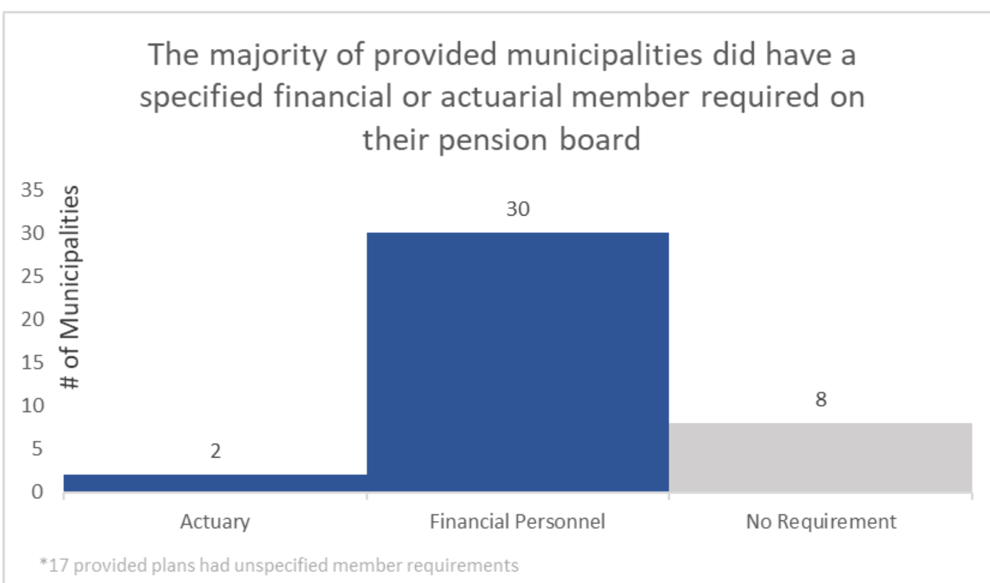
Retirement plans offered by Connecticut municipalities show a variety of governance structures. While a small number of plans are overseen by municipalities' Human Resources departments, others fall under the jurisdiction of the Board of Finance. Still others are administered entirely by one or a few town employees — typically a Town Manager, a Finance Director, a First Selectman, or a combination thereof — who are authorized to work with external investment and actuarial consultants. A majority of municipalities have a dedicated committee, board, or commission that oversees retirement and pensions. The role of some of these committees is limited to the investment of plan assets. The size of these pension committees, and the number of plans they oversee, varies widely from municipality to municipality:

Figure 1:



In some cases, the committees must include members with actuarial or pension investment expertise. A majority require the inclusion of members with some kind of financial expertise, a small number require actuarial expertise, and a significant minority have no specific requirement:

Figure 2:

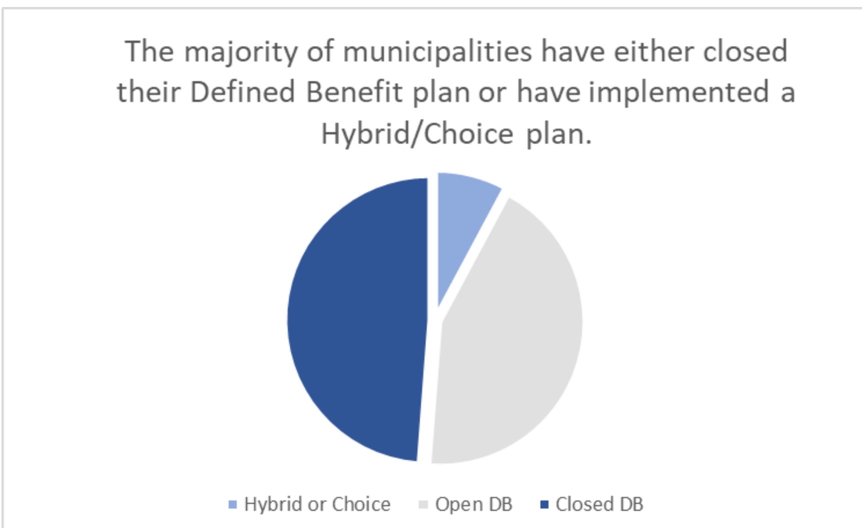


According to Boston College Center for Retirement Research[2], both expertise and representativeness are vital to pension board efficacy, though are not mutually exclusive. The plans overseen by committees with some requirement of expertise tend to outperform their peers. This is also evident within data of the small sample size that was received through the municipal survey. One reporting municipality whose committee includes both finance personnel and union representatives, and which meets quarterly to receive independent reviews of the performance of plan investments, has succeeded in remaining overfunded in recent years, with minimal contributions required to keep the level stable. Conversely, another reporting plan that is overseen by an Ad Hoc Pension Committee has historically been underfunded.

Shifts In Types of Retirement Plans Offered

According to a 2023 national study conducted by the National Conference on Public Employee Retirement Systems, government retirement systems are increasingly offering defined contribution plans, deferred compensation plans[3], and other alternatives to the traditional defined benefit plan.[4] Our survey showed that Connecticut retirement plans have followed this trend. Connecticut municipalities sponsor 212 defined benefit plans and 137 defined contribution plans. Eighty-one defined benefit plans, previously offered by 57 different municipalities, have closed.

Figure 3:



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[2] [Does Public Pension Board Composition Impact Returns? – Center for Retirement Research (bc.edu)]

[3] A defined contribution plan allows employees to place a portion of their income in a tax-deferred investment account. Employers typically contribute to the account, as well. In many cases, participation in the defined contribution plan is mandatory, and the levels of contribution are fixed by the terms of the plan. Many employers also offer a voluntary "deferred compensation" plan, in which employees may defer taxation on an additional portion of their compensation by placing it in a separate investment account.

[4] NCPERSPublicRetirementSystemsStudy2023.pdf.

Funded Status and Plan Contributions

Some key plan indicators are funded ratios, the fully payment of the ADEC, and contribution rates. Funded ratios reflect a plan's ability to fulfill its future spending obligations. The percentage of the ADEC that is being paid shows the extent to which an employer has already met its financial commitments.

Contribution rates show the financial cost on both employers and employees that will be required to sustain the pension system.

The following table uses these various measures to show how municipal plans in Connecticut are performing. The presence of significant outliers within the dataset has notably skewed some of the averages. These outliers represent extreme values that deviate substantially from most of the data points, exerting a disproportionate influence on the calculated averages. As a result, the reported averages may not accurately reflect the central tendency of the dataset and should be interpreted with caution, paying careful attention to the minimum, maximum, and median values; these values will help put the stated averages into context.

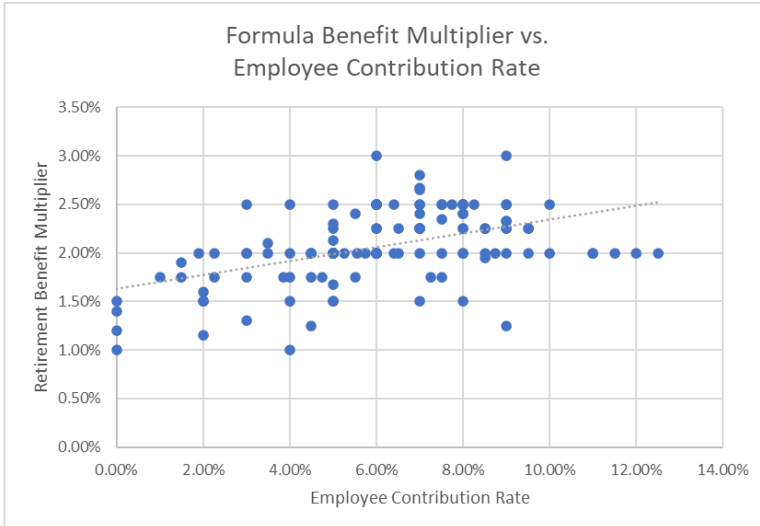
Table 1: Summary of Plan Features[5]

	Average	*Median*	*Lowest*	*Highest*
Funded Ratio	79.05%	79.20%	34.80%	128.10%
Percentage of ADEC Paid	106.60%	100.00%	0.00%	740.00%
Employer Normal Cost Rate	15.01%	13.30%	4.40%	43.35%
Employer Required Contribution Rate	65.87%	28.91%	-5.82%	1527.76%
Employee Contribution Rate	5.50%	5.63%	0.00%	12.00%
Benefit Multiplier	2.03%	2.00%	1.00%	3.00%
Normal Retirement Age	61 years	64.5 years	45 years	65 years
Minimum Service Requirement	10.64 years	10 years	1 year	26 years

Furthermore, acknowledging the sample size, the survey results suggest a general trend in which there is somewhat of a positive correlation between employee contribution rates and multipliers in the benefit formula. In other words, plans promising greater benefits may require employees to contribute somewhat more to their pensions:

[5] Major outliers within the data, specifically abnormally high or abnormally low contribution rates or percentages of ADEC paid, tend to skew the averages of the overall data points.

Figure 4:



This measure also illustrates a difference between plans whose members are municipal employees in general and those that are limited to public safety employees. General employee pension schemes have an average employee contribution rate of 5.04%, with an average benefit multiplier of 1.93%. Public safety pension plans—specifically those for police and fire departments—exhibit a higher average employee contribution rate of 7.40% and a slightly elevated average multiplier of 2.23%.

Comparison to National Data

Across the United States, the average municipal defined benefit plan has a funded ratio of 77.8% and requires employer contributions equal to 24% of payroll. As the following tables show, Connecticut's municipal plans vary widely in comparison with these national averages.

Figure 5:

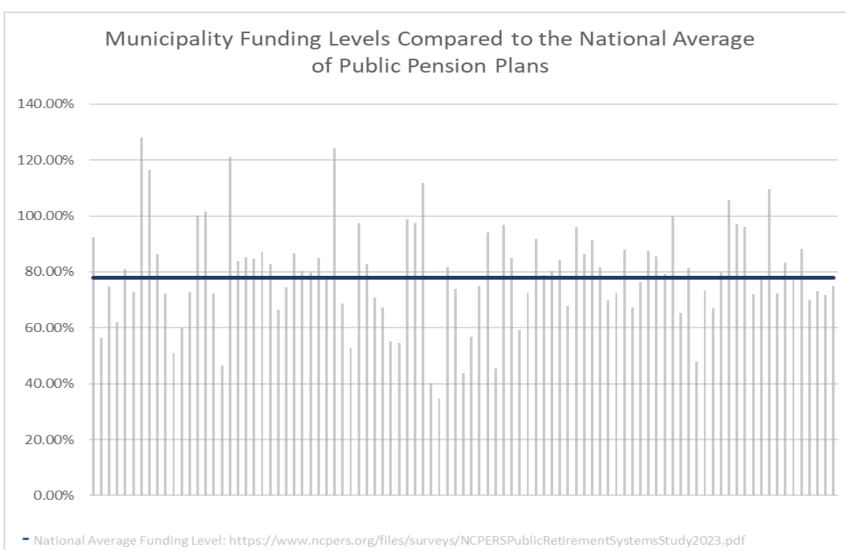
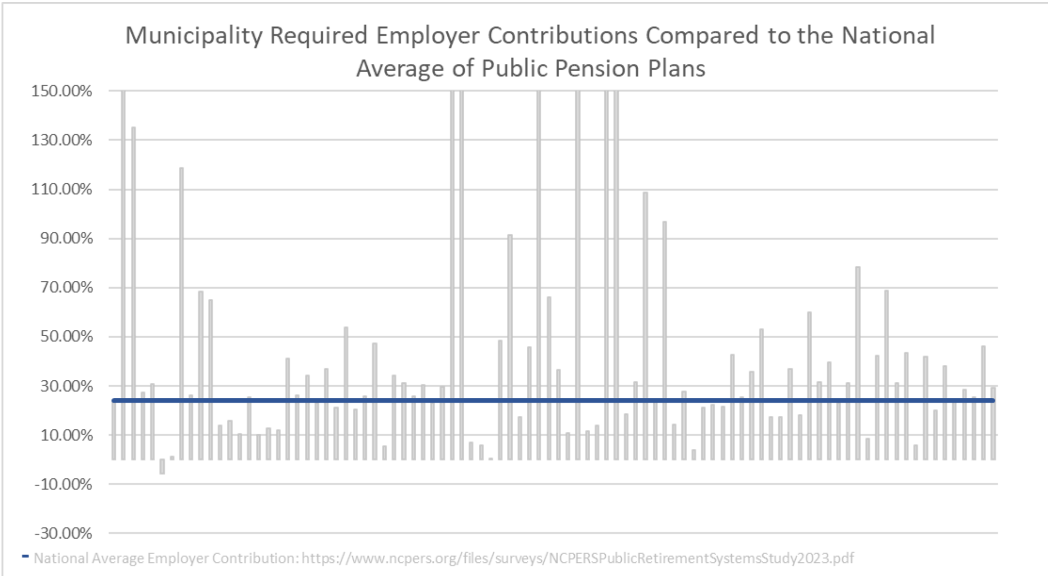


Figure 6:

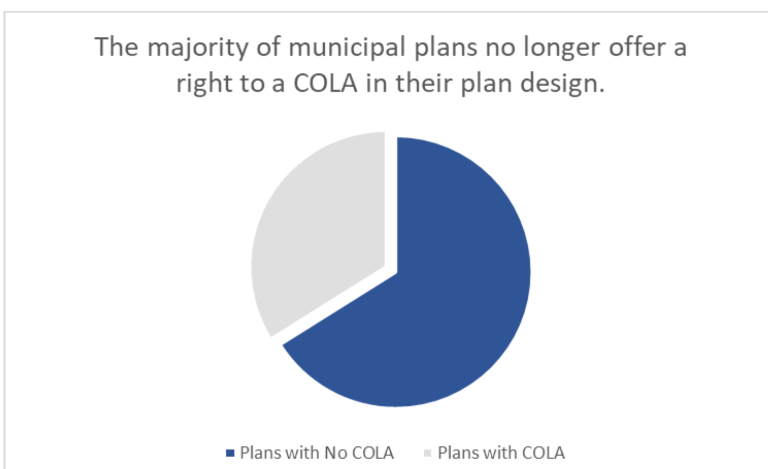


Plan Design Features

Cost-of-Living Adjustments (COLAs) in Defined Benefit Plans

Approximately one-quarter of defined benefit retirement plans for general employees that responded to the survey provide an annual cost-of-living adjustment (COLA) to employee pensions, while the remaining 75% do not. Approximately 42% of public safety plans offer a COLA, while 58% do not. Overall, a majority of municipal plans have opted against including a COLA in their plan design:

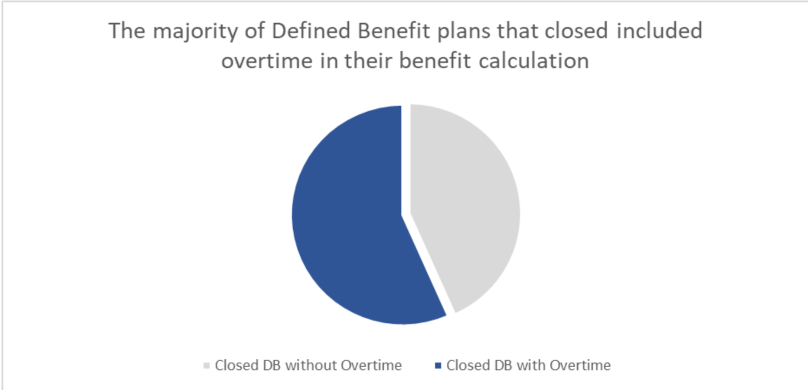
Figure 7:



Inclusion of Overtime in Benefit Formulas for DB Plans

In a typical defined benefit plan, the formula that determines the amount of a retiree's retirement income takes account of (among other things) the amount of compensation the retiree received during his or her active employment. Retirement plans differ over whether an employee's overtime compensation (OT) is pensionable compensation but there appears to be a trend favoring *exclusion*. About half of the plans for which we received information in the survey incorporate OT into their benefit formula, but 61% of those plans are now closed. In fact, of the municipal defined benefit that were covered by our survey, and which had already closed, a majority were plans that took account of OT in their benefit calculation. This does follow national trends that indicate fewer plans are including overtime in their calculation: According to the National Conference on Public Employees Retirement Systems 2024 study, the inclusion of overtime dropped seven percentage points from the 2023 study[6].

Figure 8:



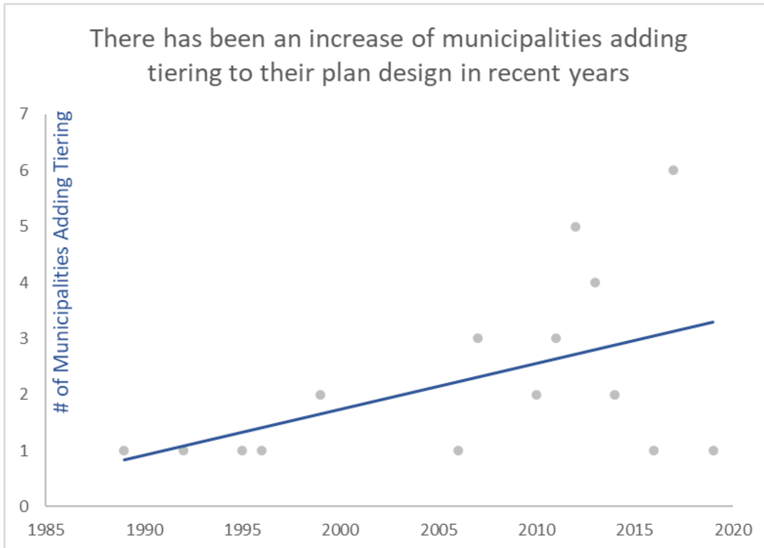
As an alternative to factoring OT into the calculation of retirement income, some plans provide that employees may contribute an amount based on their OT to a defined contribution plan. This arrangement puts less strain on the finances of the DB plan while still providing employees with a retirement benefit based on their OT.

Tiering in Retirement Plans

The implementation of a tiered structure within public retirement systems has emerged as a prominent strategy to address accrued actuarial liabilities and enhance the sustainability of pension plans. Tiering involves the creation of different levels, or “tiers,” within the pension system, typically characterized by varying contribution levels, benefit formulas, or eligibility criteria. In the NCPERS 2023 study on public retirement systems, study respondents reported implementing tiers with increased contribution levels to reduce accrued actuarial liabilities.[7]

[6] NCPERSPublicRetirementSystemsStudy2024(ncpers.org)
[7] NCPERSPublicRetirementSystemsStudy2023.pdf

Figure 9:



Defined Contribution Plan Contribution Levels

On average, employees contribute about 6.59% of their income towards defined contribution or deferred compensation plans, while employers contribute an average of 7.12%.

BEST PRACTICES

The following discussion reflects a review of the literature regarding best practices for government retirement plans.

Governance of Pension Plans

By instituting widely recognized best practices in governance and oversight, pension plans and their governing bodies can enhance accountability, consistency, and transparency, thereby leading to improved pension performance. Research finds that there is a strong link between best practices and performance, suggesting that effective governance may improve long term investment returns annually by 1% or more[8].

There are many factors to consider when crafting a governance structure for a pension plan, including board size, member composition, term limits, roles and expectations, and board education, among others sourced from industry literature. The following sections outline best practices for each of the principal components of a board's structure. Nevertheless, retirement plans should tailor their governance structures to the specific circumstances relevant to their individual situations.

[8] National Conference on Public Employee Retirement Systems (NCPERS), Best Governance Practices for Public Retirement Systems

Oversight Model

The three most popular models for oversight of state and local pensions funds are: a single fiduciary board; separate fiduciary boards with responsibility for, respectively, administration and investment; and a sole fiduciary.

The single fiduciary board model often includes an investment subcommittee that offers recommendations to the board. This is the most popular board structure, governing nearly three-quarters of public plans in the United States[9]. The second most common model employs separate administrative and investment boards. The sole fiduciary model invests a single, ex-officio member with authority over the plan.

Board Member Composition

While there is no "one-size-fits-all" approach to public pension plan governance, there is a consensus throughout best practice research that the board overseeing such plans should reflect the varied interests of all stakeholders. Active employees, retired members, government officials, taxpayers, subject matter experts, and a spectrum of union representatives should all be reflected in the makeup of a pension board. Another measure to consider is the presence of board members who possess some relevant expertise in pensions, financial investments, actuarial knowledge, and/or retirement systems, all important aspects to the success of a governing body. A balance between stakeholder representation and relevant expertise helps a board fulfill its fiduciary responsibility.

Board Size

The size of retirement boards fluctuates significantly across states and municipalities alike. Some boards comprise as few as 5 members, while others include as many as 19. While the optimal size of a board depends on the unique needs of the retirement system, many pension experts recommend a middle ground typically between 6 and 10 members; the median public retirement system board size is nine members[10]. A board with too few members may indicate a lack of adequate representation, while an excessively large board can face problems in coming to decisions.

Board Member Tenure

The duration of a member's service on a fiduciary board significantly influences the overall oversight of the retirement plan. Members' serving too long a term might deprive the board of fresh ideas and new insights, while constant turnover might bring members who lack familiarity with the intricacies of the plan and its operations. Developing a cohesive group of experienced and knowledgeable members requires time and resources, so frequent turnover can greatly impede the board's ability to fulfill its duties effectively. Prevailing best practices suggest three, three-year terms as the most desirable tenure for board members.[11]

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[9] "Does Public Pension Board Composition Impact Returns?" Boston College Center for Retirement Research
[10] Board Composition.pdf (nasra.org)
[11] "Does Public Pension Board Composition Impact Returns?" Boston College Center for Retirement Research

Board Member Education

Creating and maintaining a well-informed and well-educated board is an obvious way to promote effective governance. As noted above, it is important that the board include individuals who are experts in fields such as retirement and pension investments and actuarial science. But it is also important for the board to represent all stakeholders, including some who are likely to lack such expertise. For this reason, NCPERS recommends adopting a continuing fiduciary education program to develop and refine the skill sets of board members. The Government Finance Officers Association (GFOA) suggests providing all new trustees with an orientation that covers their responsibilities, fiduciary duties, and the roles of other system employees.[12] Ongoing education programs must be established and upheld in accordance with relevant laws, and participation should be mandatory.

Governing Roles and Expectations

The role and responsibility of a fiduciary board—whether it covers only administrative issues or both administration and investment—should be clearly outlined. The GFOA suggests that boards conduct regular self-assessments to evaluate their fulfillment of duties and to gauge the effectiveness of their oversight processes. Governing boards are also expected to report transparently on their structure and on the status of the plan.

Board Policies

Retirement boards should adopt and adhere to a set of policies that are written in language that is clear enough for all stakeholders to understand. These policies should be updated regularly to respond to structural, statutory, or goal-related changes to the plan. The policies should encompass a variety of ideas, including:

1. A mission statement defining the system's vision and objectives.
2. An investment policy statement.
3. Standards of personal conduct.
4. A communications policy.
5. A code of ethics.
6. A privacy policy.
7. A risk management policy.

These written policies should be clear, concise, easy to understand, and practical. The GFOA recommends adopting and maintaining a governance manual that houses all board policies and thereby promotes transparency with stakeholders. In addition to adopting these necessary policies, it is important that funds develop a documented strategic plan that will assist in the implementation of the plan's objectives.

Risk Oversight

A fundamental responsibility of any board governing a public fund is risk oversight. NCPERS advises that funds adopt a risk management framework that is formally documented in a risk policy statement or integrated within other policy documents. Furthermore, the board should delegate responsibility for

[12] Governance of Public Employee Postretirement Benefits Systems (gfoa.org)

monitoring various risks, including market, credit, operational, asset/liability, and liquidity risks. Board reports should include key performance measures and risk metrics to aid in evaluating the fund's progress towards their documented objectives.

Pension Investments

The Office of the State Treasurer, State of Connecticut, provided a selection of pension investment policies and procedures best practices that emphasize the proactive steps that government entities should be taking and are applicable to all sized governments[13]. These best practices have been promoted and approved by the executive board of the Government Finance Officers Association, a professional association representing public finance officials of both the United Stated and Canada that provides education and resources.

Investment Policy

Establishing a comprehensive written investment policy, adopted by the governing body, is a main component of the success of public fund investment programs, as they not only identify investment objectives and how the program will be managed and monitored, but also serve as a communication tool to staff, elected officials, the public, and any stakeholders. This policy should be reviewed and updated annually to maintain relevance, along with providing statements on the following[14]:

1. Scope and investment objectives.
2. Roles, responsibilities, and standards of care.
3. Suitable and authorized investments.
4. Investment diversification.
5. Safekeeping, custody, and internal controls.
6. Authorized financial institutions, depositories, and broker/dealers.
7. Risk and performance standards.
8. Reporting and disclosure statements.

For government retirement systems that provide a defined benefit pension plan, the investment policy should establish an asset allocation plan[15]. No asset allocation model is right for every plan, so a mix of assets is typically chosen at an acceptable level of risk. It is recommended that the governing body of these pension plans should also work closely with actuaries and other advisors, and review the portfolio performance preferably quarterly, but at minimum annually, to ensure compliance.

Third-Party Investment Professionals

Many government entities retain third-party investment managers and advisors to perform tasks related to their asset investments ranging from consulting to full management. With the investment committee having overall fiduciary responsibility for the public pension plan assets, it is important that government officials do their due diligence in selecting third-party investment professionals. There has been

[13] Treasury and Investment Management (gfoa.org)
[14] Investment Policy (gfoa.org)
[15] Asset Allocation for Defined Benefit Plans (gfoa.org)

increased scrutiny in third-party investment professionals and public funds; to address this, the Government Finance Officers Association suggests policies focusing on the selection of these professionals be created and adopted[16].

Third-Party Safekeeping and Custodian Services

The primary investment objective of public pension funds should be the safety of the assets. One main component of this is the separation of the safekeeping (many financial institutions use the term safekeeping and custody interchangeably) from the investment function, which acts as one important protection from the possibility of fraud. The safekeeping account does not protect the governing body from making a bad investment choice. This objective should be defined and included in the investment policy that is adopted by the governing body. The separation of the investment firm and safekeeping of securities allows for transactions to happen on a delivery vs payment basis, meaning that the secure delivery and payment occur simultaneously. It is imperative that the governing body weigh risks and understand how not having a separate safekeeping provider would impact the government's ability to access the investment assets.

Securities Litigation Class Actions

There is a fiduciary obligation of public pension plans to recover funds that are lost through investments in public securities as the result of corporate mismanagement or fraud. The Government Finance Officers Association recommends that each public pension plan have a policy on monitoring and participating in class action securities litigation, adopted by the governing body[17]. This policy should have a set of objectives that fulfill the fiduciary duty of managing claims, maximizing the recovery amount while minimizing the fees to obtain recovery, and evaluating when individual cases should be taken rather than a class action when the losses are of a certain threshold. The policy should also have clear procedures on serving as lead plaintiff in the class action securities litigation, monitoring procedures, participating in the recovery of settled claims, reporting, and the roles, responsibilities, and selection of legal advisors.

Managing Market Risk

Market risk (also referred to as interest rate risk) refers to how the changing interest rates affect the present value of a fixed-income security. Longer maturities have greater volatility, as each change in the interest rate has an impact on the present value of the security. The Governmental Account Standards Board (GASB) do require a disclosure of all risks associated with the entity's portfolio. There are five accepted methods for disclosing a portfolio's market risk, the Government Finance Officers Association document weighted average maturity or weighted average duration in their best practices[18]. It is recommended by GFOA that the following be implemented in regards to managing market risk:

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[16] Selecting Third-Party Investment Professionals for Pension Fund Assets (gfoa.org)
[17] Developing a Policy to Participate in Securities Litigation Class Actions (gfoa.org)
[18] Managing Market Risk in Investment Portfolios (gfoa.org)

1. Develop and update cash flow projections.
2. Structure the portfolio to ensure sufficient liquidity for anticipated cash flow.
3. Prior to purchase, fully understand the maturity structure.
4. Adopt weighted average maturity limitations or weighted average duration targets.
5. Follow the limits imposed by the investment policy.

Portfolio Benchmarks

Implementing benchmarks to assess the portfolios risk and return is a technique to verify that objectives are being met. This is needed as the investment yield is useful for overall budgeting but is unreliable in assessing the risk and performance and can be distorted and manipulated depending on the particular period of time. The Government Finance Officers Association recommends the governing body assess their portfolios with carefully selected benchmarks[19]. These benchmarks should be updated on a regular basis and reflect the policy constraints and management practices.

RECOMMENDATIONS

Based on the findings of the survey data collected, research on overarching best practices in governance structures and pension investments, as well as consideration of ways in which the State can partner with municipalities to improve management of funds, the following recommendations are offered:

Overtime Earnings Trend

If a municipality is looking to control certain costs, an emerging option that defined benefit plans are starting to trend towards is transferring the inclusion of overtime earnings to a defined contribution plan. It was evidenced from respondents that this transfer did not hinder the retention rates of employees in the long run, but instead kept the option of continuing to offer a defined benefit retirement plan viable.

Reconsider the Connecticut Municipal Employees Retirement System

The aforementioned reforms to CMERS sought to mitigate employer costs and create a sustainable path forward for the plan, savings municipalities over $700 million over the next 30 years. Those changes, combined with a new governance structure coming later in 2024 that gives stakeholders greater decision-making power, may make CMERS a more attractive option than in the past. The plan is also an effective tool at recruiting and retaining talent, especially those in public safety positions.

Comptroller’s Office to provide option to join a defined contribution plan

If the municipality offers a defined contribution plan, they could consider the option of joining a new municipal defined contribution plan, administered by the State Comptroller. This option would alleviate the burden of investments costs by pooling assets for better investment opportunities and access to investment types that might otherwise not be possible.

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[19] Using Benchmarks to Assess Portfolio Risk and Return (gfoa.org)

Treasurer's Office to provide option to join a defined benefit MUNI Trust option

There is also a route for non-participating Connecticut Municipal Employees Retirement System (CMERS) municipalities to invest their pension assets with the state by participating in the Treasurer's MUNI Trust. Pursuant to PA 21-2, Section 292 and 293, the Office of the Treasurer will now allow any Connecticut municipal retirement fund, not already invested in CMERS, to invest all or a portion of their assets through the Treasurer's Combined Retirement Plans and Trust Fund under the new MUNI Trust program, effective July 1, 2024.

This will allow a municipality to enjoy reduced investment fees due to economies of scale, provide access to other types of investments that may not otherwise be feasible, and eliminate the need to fund a variety of investment consultant fees.

Governance Structure

Many of the leading organizations in public retirement systems, such as the National Conference on Public Employee Retirement Systems, Government Finance Officers Association, and the Center for Retirement Research at Boston College, endorse governance structures with features that best translate over many different plan sizes, but each entity should adjust and create a structure that suits the needs of their members. The following is a summary of some of those factors based on these presiding best practices research:

Feature	***Considerations***	***Comments***
Member Composition[20]	Employee trustees Municipal/employer trustees Expert trustees Ex-officio member(s)	Public safety representative, retired member of the system Members who possess some relevant expertise in finances or investment, actuarial knowledge, retirement/pensions
Member Education	New member orientation, fiduciary duty training, participation in continuing education[21]	The National Conference of Public Employee Retirement Systems provides Trustee Training
Roles and Expectations	Roles clearly outlined Conduct self-assessments regularly Transparently report	Encompass all responsibilities Gauge oversight effectiveness Report on structure and status of plan

[20] Does Public Pension Board Composition Impact Returns? – Center for Retirement Research (bc.edu)
[21] Governance of Public Employee Postretirement Benefits Systems (gfoa.org)

Board Policies[22]	Mission statement Investment policy statement Personal conduct standards Communications policy Code of ethics Privacy policy Risk management policy	Update all policies regularly, maintain governance manual to store policies, develop a strategic plan
Risk Oversight	Create risk management framework Delegate oversight responsibilities	Formally document in policies Market, credit, operational, asset/liability, liquidity risks, among others

DISCLOSURE FROM THE OFFICE OF THE STATE COMPTROLLER

Each entity is unique, and plan design or governance should be customized to the specific objectives therefrom. This document has been prepared for general informational purposes only; it has not been prepared with regard to the objectives or situation of any particular entity, and no advisory or other relationship is created by this document or any related communication. Nothing in this document constitutes, or should be construed as legal, or other professional advice.

Pension Investments

Additionally, the recommendations for investment best practices are being offered by the Office of the State Treasurer, State of Connecticut, to municipal investment pension funds relative managing of pension plan investment as part of a report required pursuant to Public Act 23-182 Section 6. These recommendations are as follows:

Investment Policy

It is recommended that all pension fund systems, including local municipal pension systems, adopt a formal Investment Policy. The following are guiding principles offered as general standards that govern the investment process and investment oversight:

1. Establishing a long-term strategic asset allocation ("SAA") plan is paramount and critical to achieving the targeted risk-return objectives for each plan. The SAA should incorporate consideration of:
    a. Capital market assumptions for each asset class;
    b. Goals for the financial health and liquidity of the plan;

[22] Best Governance Practice on PERS (ncpers.org)

c. Prudent diversification on investment to reduce risk; and,
d. Detailing of permissible investments

An annual review of the SAA relative to objectives is part of prudent governance best practices.

2. Pension fund investment governance structure, duties and responsibilities should be outlined and codified through bylaws, charters, and policies, as appropriate, for the investment board or other governing body empowered with overseeing pension fund investments.
3. Governance documents should be periodically reviewed and updated to accommodate changes in law, regulation and/or changed circumstances.
4. Overall investment philosophy and objectives should include consideration of expectations for long-term return targets and risk tolerance.

Investment Process

The investment process should include consideration of, among other things:

1. **Strategic Asset Allocation and Plan Asset Liability Studies.** This is a plan for allocating the investment assets to various asset classes in a strategic manner to meet long-term benefit obligations over a variety of market conditions.
2. **Capital Markets Expectations/Assumptions (Long-Term).** This is the professional view regarding the environment and opportunities for return and risk in the capital markets over the long term.
3. **Capital Markets Outlook (Short-Term).** This is the professional view regarding the environment and opportunities for return and risk in the capital markets in the near term.
4. **Actuarial Evaluation of the Pension Plan.** It is recommended that the investment governing body carefully review the actuarial valuation for the plan and consider how the investment policy positions the plan to meet the long-term benefits obligation over time and make changes as appropriate.
5. **Multi-Asset Class Diversification and Targets.** This involves setting ranges and targets for allocation of plans' assets to investment in different asset types consistent with the Strategic Asset Allocation plan.

Investment Oversight and Monitoring

It is recommended that there be active oversight and monitoring of the investment which should include consideration of, among other things:

1. Roles of Investment Board/Trustees and/or Advisory Committees.
2. Plan Peer Comparison for comparable pension plans.
3. Investment Guidelines, Benchmarking, Active/Passive mandates consideration.
4. Details around the process for selection of asset managers or funds for different asset types through RFP/RFI competitive bid process detailing.
5. Rebalancing Policy and Liquidity Profile/Needs.
6. Roles of Advisors/Consultants.

7. Manager Performance should be monitored on an ongoing basis, including the development of a Manager Watch List process for underperforming managers to ensure performance evaluation standards for the plan.
8. Compliance with applicable laws, rules and regulations governing pension fund investment and governance.

Portfolio Construction – Investment Managers

The number of investment managers should be optimized to avoid overdiversification and generate economies of scale, when possible. Many managers offer "fee breaks" as the amount of funds invested with the manager increases.

Managing Market Risk in Investment Portfolios

The GFOA Recommendations for Managing Market Risk in Investment Portfolios are quite narrow. More considerations are recommended. For example, if the plan seeks to invest in a range of fixed income securities such as investment grade credit, high yield bonds, emerging market bonds, etc., then the assessment of risk should be expanded beyond modified duration included in the GFOA Best Practices to include considerations such as credit spread duration, industry concentration, issuer concentration, convexity, mortgage duration, etc.

Safeguarding/Safekeeping Practices for Plan Asset

The safekeeping/safeguarding of plan assets should include consideration of, among other things:

1. Use of custodial arrangements, which is highly desirable due to protections provided by their “Trust/Fiduciary” standards.
2. Segregation of duties between Administrator and Custodian to reduce risk and improve oversight.
3. Separately Managed Accounts provide strong “Beneficial Ownership” and segregation of assets registered on behalf of the plan (vs brokerage or administrator).
4. Independent /External Audit of plans assets and investment on an annual basis.

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Each entity is unique and investment governance should be customized to the specific objectives of the entity. This document has been prepared for general informational purposes only; it has not been prepared with regard to the investment objectives or financial situation of any particular entity, or the suitability of a particular investment or transaction for any entity, and no advisory or other relationship is created by this document or any related communication. Nothing in this document constitutes, or should be construed as, investment, legal, taxation, ERISA, financial, accounting, or other professional advice.