

New York State
Office of the State Comptroller



Thomas P. DiNapoli
State Comptroller

**REPORT OF THE
PENSION TASK FORCE**

TASK FORCE MEMBERS

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former Treasurer of the Commonwealth of Massachusetts

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Peter Clapman

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Wayne Diesel

former New York State Budget Director

Alan Lubin

Executive Vice President of NYSUT

Diana Taylor

Managing Director, Wolfensohn and Co.



No more sacrosanct duty exists among those assigned to the New York State Comptroller by the State Constitution than serving as sole fiduciary of the New York State Common Retirement Fund. This constitutional duty requires me to protect the retirement assets of over one million members, beneficiaries and retirees – those dedicated public servants in state and local government who protect and

serve the people of New York.

Therefore, I am very pleased to accept the Report of the Pension Fund Task Force, an independent advisory board that I convened to review safeguards I put in place and recommend additional measures for ensuring the sound and ethical management of the Common Retirement Fund. The Task Force has examined a number of critical matters, including reporting by investment managers of any third party payments, disclosure of Fund performance, and the role and requirements of advisory bodies, as well as implementation of recently promulgated State Insurance Department regulations and other best practices.

The Task Force's recommendations, taken together with the safeguards and new independent oversight positions I established upon taking office, will provide a secure and transparent foundation for the long term investment of the Common Retirement Fund for the benefit of the members, beneficiaries and retirees of the Retirement Systems.

I encourage the members, beneficiaries and retirees of the Systems, as well as our partners in state and local government and all New York State citizens, to review this Report and to be assured that the Fund operates with integrity, efficiency, transparency, accountability and effectiveness and is among the best and well funded public pension systems in the country.

I offer my sincere appreciation to Chair Shannon O'Brien, Task Force members Wale Adeosun, Peter Clapman, Wayne Diesel, Alan Lubin and Diana Taylor, and the many Comptroller's Office staff, State Insurance Department colleagues and others who have contributed to this important endeavor.

Sincerely,

Thomas P. DiNapoli
State Comptroller

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EXECUTIVE SUMMARY

BACKGROUND OF INITIATIVE

Comptroller Thomas P. DiNapoli was selected to serve as the 54th Comptroller of the State of New York on February 7, 2007. Upon taking office, Comptroller DiNapoli took decisive action to restore integrity to the Office of the State Comptroller, imposing a variety of ethics reforms to address the manner in which the Common Retirement Fund (“CRF” or the “Fund”) is managed.

Mr. DiNapoli came to office with a pledge to promote good governance. Upon taking office, Comptroller DiNapoli began to address the issues of potential conflicts of interest in the payment of placement agent fees by investment managers to third parties in connection with CRF investments.

In addition, Comptroller DiNapoli took several steps to improve the investment process by adopting policies and procedures to strengthen internal controls and to increase oversight and transparency. These actions included:

- ◆ Establishing and implementing a system to publicly report and review any placement agent fees paid by investment managers in connection with CRF investments;
- ◆ Issuing an Executive Order on Ethics that, among other things, bars staff from accepting any gifts;
- ◆ Creating new positions of Inspector General and Special Counsel for Ethics within OSC to increase oversight and establish a comprehensive ethics program;
- ◆ Implementing mandatory ethics training for all staff and the Comptroller, including special training for investment staff; and
- ◆ Requiring public disclosure of investment transactions and placement agent fees.

At the same time, Comptroller DiNapoli collaborated with the Superintendent of Insurance to develop a new regulatory framework for the Fund. These regulations, which include additional oversight activities, have been adopted. The Comptroller is currently in the process of implementing such regulations.

THE TASK FORCE

The steps outlined above and other safeguards directed by Comptroller DiNapoli have resulted in greater transparency and oversight of both CRF, and the OSC as a whole. Comptroller DiNapoli views these reforms as initial measures and simultaneously expressed his intention to move forward and consider new and additional safeguards to maximize the integrity of the operations of OSC and ensure the ethical oversight of CRF assets and investments.

In December 2007, with the cooperation and active involvement of the Governor and Superintendent of Insurance, the Comptroller convened a special Task Force to perform a comprehensive independent review and assessment of the operations, policies and practices of CRF and to make recommendations on both short-term actions and long-term best practices for the Fund.

The Comptroller asked the Task Force to assess the adequacy of safeguards and controls that currently exist for the CRF (including those put in place by the Comptroller upon taking office) and to recommend additional safeguards and controls in the areas of oversight, transparency, and decision making at CRF. The Comptroller also asked the Task Force for input on how to best position CRF for the long-term in order to continue to operate as a world class Fund in an ever changing, complex, and competitive investment environment.

The Comptroller asked Shannon O'Brien, the former Treasurer of the Commonwealth of Massachusetts, to chair the Task Force. Chair O'Brien brings extensive prior experience in the oversight of public pension operations. Including Chair O'Brien, the Task Force is comprised of six members, chosen for their expertise in pension fund management, governance, investments and employee benefits. Task Force members are Walé Adeosun, Peter Clapman, Wayne Diesel, Alan Lubin and Diana Taylor. A description of Task Force member experience can be found on pages nine and ten of this report. Aided by an independent consulting firm selected through an open, competitive process, the Task Force met 10 times over the course of 12 months, reviewed extensive documentation, deliberated thoroughly on matters before it, and adopted a series of specific recommendations to the Comptroller. These recommendations are intended to strengthen practices in three interrelated areas – ethics, oversight and accountability; transparency; and investment decision making.

KEY RECOMMENDATIONS OF THE TASK FORCE

The following is a summary of key recommendations made by the Task Force:

- ◆ Effective immediately, CRF will report investment performance results quarterly, in addition to publishing results in the Comprehensive Annual Financial Report;
- ◆ CRF policies will be made available to the public through publication on the OSC web site;
- ◆ Placement agent fees, if any, paid by investment managers will continue to be disclosed prior to investment of CRF assets;
- ◆ All transactions of CRF will be released in a timely manner to the public on the OSC website;
- ◆ A newly formed internal investment committee will provide additional transparency in the internal investment decision making process;
- ◆ The external Investment Advisory Committee which provides independent advice to the Comptroller and CRF staff will be expanded and strengthened;
- ◆ Members of the external Investment Advisory and Real Estate Advisory Committees will be subject to increased financial disclosure in order to minimize potential conflicts of interest;

- ◆ The current policies prohibiting insider trading and misuse of confidential information applicable to Advisory Committees will be updated and expanded, and Advisory Committee members will be required to fulfill ethics training in connection with their service;
- ◆ A CRF compliance officer will be appointed, reporting to the Deputy Comptroller for Retirement Services, to better monitor potential conflicts and/or unethical behavior; and
- ◆ The existing Code of Ethics will be strengthened by adding enhanced conflict of interest disclosure and enforcement provisions.

As indicated above, the Comptroller has already begun implementing many of the recommendations of the Task Force.

The Task Force believes that continuing the reforms already introduced, together with implementing its recommendations, will provide a solid foundation for the continued operation of CRF according to the highest ethical standards and consistent with the best practices utilized by its peers.

PENSION FUND TASK FORCE

In December 2007, with the cooperation and active involvement of the Governor and the Superintendent of Insurance, the Comptroller convened a special Task Force to perform a comprehensive independent review and assessment of the operations, policies and practices of CRF and to make recommendations on both short-term corrective actions and long-term best practices for the Fund.

Specifically, the Comptroller asked the Task Force to:

1. Assess the adequacy of safeguards and controls that currently govern the operations of CRF (including those put in place by the Comptroller upon taking office);
2. Recommend additional safeguards and controls in the areas of transparency, oversight, and decision making at CRF;
3. Advise the Comptroller on the relative priority, risk, cost-benefit and resource implications of some of these measures;
4. Ensure CRF is best positioned for the long-term to continue to operate as a world class fund in an ever changing, complex, and competitive investment environment; and
5. Consider how its recommendations address compliance with recently the Insurance Department Regulations.

The Task Force began meeting in February 2008. Assisted by an independent consultant, the Task Force met 10 times over the course of 12 months and adopted a series of recommendations that are presented in full in this report. For a more detailed description of the selection process for, and scope of work of, the Consultant, see pages 43-46.

TASK FORCE MEMBERS

Shannon O'Brien – Chair

Chair O'Brien has worked in both the government sector and in the pension arena in very significant positions in the Commonwealth of Massachusetts including as the State Treasurer and Chair of the Pension Reserves Investment Management Board. In addition, she has served as a State legislator and she brings an understanding of the legislative perspective on policy and economic issues confronting public pension funds.

Walé Adeosun

Mr. Adeosun is the Chief Investment Officer at Rensselaer Polytechnic Institute, and has direct oversight experience with endowments, pension plans, and cash management programs. He is a chartered financial analyst and previously served with the John D. and Catherine T. MacArthur Foundation, where he was responsible for U.S. equities and investments, and in a prior capacity as a manager for Pensions and Risks Management.

Peter Clapman

Mr. Clapman retired as Senior Vice President and Chief Counsel for TIAA-CREF. Mr. Clapman has a wealth of experience concerning corporate governance, best practices for institutional investors, and corporate responsibility. He is the author of the "Clapman Report" on fund governance best practices issued by the Stanford Institutional Investors' Forum and has been repeatedly recognized as one of the most influential and respected individuals concerning corporate governance in the United States and abroad.

Wayne Diesel

Mr. Diesel has served in both the public and private sectors in very significant roles as Director of the Budget for New York State and as President and CEO of major companies. He has significant experience in business and industry relations. His broad-based government experience, where he has served as a key advisor to Governors and State Chancellors, also includes previous service with the Office of the State Comptroller.

Alan Lubin

Mr. Lubin, Executive Vice President of NYSUT, has significant experience and service with the American Federation of Teachers, the NYS AFL-CIO, and on numerous advisory groups concerning higher education, benefits for retired public employees, and school safety. He has been recognized by a host of groups and organizations for his efforts as an educator and union leader, and he brings a strong labor and member perspective to the Task Force.

Diana Taylor

Ms. Taylor started her career as an investment banker, working for several top firms, including Smith Barney, and then went on to become a founding partner of M.R. Beal and Company, a boutique investment banking firm specializing in municipal finance. She has also worked in the public sector, holding various positions such as New York State Banking Superintendent, Chief Financial Officer of the Long Island Power Authority, Vice President for Community, Governmental and Regulatory Affairs at KeySpan Energy, and Deputy Secretary to the Governor for Housing and Finance. She has experience with issues concerning financially underserved communities and has served on several boards and advisory groups including the Council on Foreign Relations and for the FDIC.

BACKGROUND OF CRF

The New York State Common Retirement Fund (“CRF” or the “Fund”) is the third largest state public pension plan in the United States and among the largest pools of institutional capital globally. CRF holds assets in trust for over 1 million public sector members, retirees, and beneficiaries of the New York State and Local Employees’ Retirement System and the Police and Fire Retirement System (collectively, the “System”), which include over 3,000 participating employers. The System has the powers and privileges of a corporation. As sole trustee of CRF, the Comptroller is responsible for the performance, oversight, and management of the current and future retirement assets of its members, retirees and beneficiaries.

MISSION STATEMENT

The objective of the Fund is to manage its assets on behalf of the System’s members, retirees and beneficiaries in a manner that will meet actuarial return, minimize volatility, and protect and enhance long term value.

STRUCTURE

CRF is constituted as a trust that holds and invests the assets of the Fund for the exclusive benefit of the members, retirees and beneficiaries of the System. The Comptroller must operate CRF in a manner consistent with the fiduciary responsibility required of him as sole trustee of the Fund. With staff support from the Deputy Comptroller for the Division of Pension Investment and Cash Management (“PICM”) and the General Counsel to the Comptroller and their professional staffs, and CRF’s outside counsel, consultants, and advisory committees, the Comptroller determines policies and manages the investment operations of the System. PICM staff manages the assets of the Fund on a day-to-day basis.

Because PICM functions as a division within the OSC, it is subject to the oversight, reporting and management processes of the overall organization, reporting to the First Deputy Comptroller.

FUND ASSETS

The following chart shows target allocations of asset classes within the Fund, which are based in part upon statutory restrictions on the type and amount of assets in which the Fund can invest.

	Asset Class	Target Allocation
70% Equity	Domestic Equities	35.0%
	International Equities	16.0%
	Real Estate	6.0%
	Private Equity	8.0%
	Absolute Return Strategies	5.0%
30% Fixed	Fixed Income	22.5%
	Inflation Protected Bonds	7.5%
	Fund Total	100.0%

REGULATION

The Common Retirement Fund, similar to other New York public pension plans, is subject to State statutory limitations on investments. This “legal list” system specifies broad categories of permissible investments for the Fund and is in contrast to the prudent investor standard applied to corporate pension plans under ERISA and most other state public pension plans. The following categories of investments are prescribed by statute:

- ◆ unlimited amounts in investment grade, U.S. dollar denominated bonds;
- ◆ up to 70 percent in domestic equities (of which 10 percent can be allocated to international equities); and
- ◆ up to 5 percent in real estate.

In addition to these statutory prescriptions, a “basket clause” in State law allows CRF to invest up to 25 percent of its assets consistent with the prudent investor standard (increased in 2005 from 15 percent). Asset classes such as private equity, hedge funds, international equities above the cap specified above, as well as international bonds all fall within the “basket clause”.

In addition, CRF is subject to external oversight by the State Superintendent of Insurance, who is authorized by State law to promulgate regulations applicable to all public pension plans in New York State. Working collaboratively with the State Comptroller, the Superintendent promulgated new regulations applicable to the Fund, effective in November 2008.

Investment processes are documented in a series of policies and procedures. These are prepared by staff and approved by the Comptroller and the Deputy Comptroller for PICM within the office of the State Comptroller. Under current policies and procedures, significant investment decisions must be approved by professional investment staff, an independent consultant, in-house and outside counsel, the Chief Investment Officer and the Comptroller. Adherence is tested by internal compliance, internal and external audit and audits by the State Insurance Department.

TASK FORCE RECOMMENDATIONS

The Task Force developed recommendations that fall into three categories:

- ◆ Ethics, Oversight and Accountability
- ◆ Transparency
- ◆ Investment Decision Making

While the recommendations contained in this Report are listed under one of these three headings, it should be noted that many recommendations have elements of more than one category. These recommendations, developed by the Task Force, are listed in the following table. The text of these recommendations is set forth in this Report.

Task Force Recommendations	Ethics, Oversight & Accountability	Transparency	Improved Decision Making
Code of Ethics for Committees	X		
Financial Disclosure for Committees	X	X	
Insider Trading/Misuse of Confidential Information Guidelines	X	X	
Creation of Audit Committee	X		
Placement Agent Fee Disclosure	X	X	
Use of Consultants / Conflicts of Interest	X		X
Expanded Compliance Role	X		X
Increased Reporting of Fund Transactions	X	X	
Investment Policy Statement		X	X
Procurement Guidelines	X	X	X
Creation of Internal Investment Committee	X	X	X
Strengthening of Role of Investment Advisory Committee	X		X
Indemnification of Real Estate Advisory Committee			X

ETHICS, OVERSIGHT AND ACCOUNTABILITY

CONSIDERATIONS FOR COMMITTEES

COMMITTEES

Five committees are established currently by statute or regulation to advise the Comptroller on the operations of the Common Retirement Fund. These committees include the Investment Advisory Committee (IAC), the Real Estate Advisory Committee (REAC), the Actuarial Advisory Committee, the Advisory Council for the Retirement Systems, and the Committee on Investor Responsibility. In addition, recent Insurance Department Regulations require the establishment of an Audit Committee (collectively, “Committees”).

INSURANCE DEPARTMENT REGULATION REQUIREMENTS

The Insurance Department Regulations require the following:

The Comptroller shall establish and administer written ethical standards applicable to the members of such committees. The ethical standards shall establish a financial disclosure and conflicts of interest process designed to ensure that decisions are made for the benefit of the retirement system members and beneficiaries.

The Comptroller shall be responsible for ensuring that all members of any committees established by law or regulation or by the Comptroller to assist in the management of the retirement system or in the investment of the assets of the fund have been, (1) provided with appropriate information pertaining to their duties and their fiduciary and ethical responsibilities and (2) provided training with respect to discharge of their fiduciary duties and responsibilities to the fund.

CURRENT PRACTICE

CRF has a Code of Ethics applicable to Committees. A copy of the Code of Ethics is provided to each person appointed to any Committee and each such person must acknowledge receipt of the Code.

The existing Code of Ethics applicable to Committees restricts certain transactions and performance of services and evaluation of transactions by Committee members that may be “interested persons”. It also imposes post-service restrictions and prohibits the disclosure or use of confidential information.

TASK FORCE RECOMMENDATIONS

A. Code of Ethics for Committees

The Task Force recommends that the Code of Ethics that currently applies to Committees continue to apply, as amended below.

- ◆ Include an Enforcement section that states that, in agreeing to comply with the Code of Ethics, Committee members agree that failure to comply with the Code of Ethics or any other policy applicable to them (including the financial disclosure requirements and the insider trading policy) allows the Comptroller to take action, including removing the member from the Committee at the Comptroller’s discretion.
- ◆ Include a requirement that, at the beginning of any meeting at which an investment transaction will be reviewed, the Chair of REAC ask REAC members if any of them need to declare that participating in the review of any such investment transaction creates a conflict of interest for such member pursuant to the Code. The minutes of the meeting will reflect any such declarations and any recusals that may result.

- ◆ CRF should continue to distribute the Code of Ethics to Committee members at the time of appointment, and require such members to execute a written acknowledgement that they have received the Code and agree to abide by it.
- ◆ CRF should advise Committee members at the time of their appointment that the Comptroller is required to ensure that all members of any committees are “provided training with respect to the discharge of their fiduciary duties and responsibilities of the fund” and therefore, training is a requirement for participation on Committees.

B. Financial Disclosure for Committee Members

The Task Force recommends that the following system of financial disclosure be adopted with respect to members of IAC and REAC, but not by members of the other Committees:

A committee member must disclose whether any Affiliated Entity or any Affiliated Person has:

1. transacted business with the CRF or sought to do business with the CRF during the reporting period;
2. has an ownership interest in a CRF vendor (as identified by CRF) of the greater of 1 percent or \$25,000; or
3. is indebted to any CRF vendor, other than on terms generally available to the public.

An “Affiliated Person” shall mean a spouse, dependent or member of the household of the member.

An “Affiliated Entity” shall mean:

1. any corporation in which a member or an Affiliated Person has an ownership interest of 5 percent or greater;
2. any trust, corporation, association or partnership (including not-for-profit entities) in which a member or an Affiliated Person is a trustee, board member, officer, director or general partner; or
3. Any entity that is a source of paid employment for a member or an Affiliated Person.

Note: Securities held in discretionary accounts shall not be counted in calculating percentage ownership.

- ◆ In addition, the financial disclosure requirements should be incorporated in a document separate from the Code of Ethics, should be distributed to Committee members at the time of appointment, and members should be required to execute a written acknowledgement that they have received the financial disclosure policy and agree to abide by it.
- ◆ A financial disclosure filing should be required annually and within 30 days of appointment; CRF should require a confidential “screening” in advance of appointment of a Committee member.

C. Treatment of Confidential Information by Committee Members

The Task Force recommends that Committee members be subject to a policy similar to the policy for Insider Trading and Misuse of Material Non-Public Information and Confidential Information applicable to employees of the Division of Pension Investment and Cash Management, provided that no Committee members should be required to report specific trades.

In addition, the insider trading and misuse of confidential information requirements should be incorporated in a document separate from the Code of Ethics, should be distributed to Committee members at the time of appointment, and members should be required to execute a written acknowledgement that they have received the policy and agree to abide by it.

D. Training of Committee Members

Committee members should be advised at the time of their appointment that they will be required to participate in training with respect to the discharge of their fiduciary duties and responsibilities of the Fund.

The Comptroller should provide such training to each Committee.

AUDIT COMMITTEE

INSURANCE DEPARTMENT REGULATION REQUIREMENTS

The Insurance Department Regulations require the following:

Consistent with his or her obligations as a fiduciary, the Comptroller shall establish an audit committee for the retirement system and the fund comprised exclusively of unaffiliated persons, one of whom shall reflect the interests of public employees and one of whom shall reflect the interests of public employers. The Comptroller shall... develop an audit committee charter for the committee...

The Regulations require that the audit committee be authorized to, among other things,

- ◆ *review and report to the Comptroller on:*
 - *the internal audit plans and the internal audit and regulatory examination reports related to the retirement system and the fund;*
 - *the procurement of external auditor services by the retirement system and the fund; and*
 - *the annual audit process related to the retirement system and the fund and the Comprehensive Annual Financial Report, which shall include meeting with external auditors to review the adequacy of internal controls and significant findings and recommendations.*

- ◆ *develop quarterly progress reports to the Comptroller with respect to audit scopes, completion and significant audit findings and recommendations.*

TASK FORCE RECOMMENDATIONS

The Task Force supports the adoption of the charter calling for the establishment of an Audit Committee comprised of no less than three and no more than seven members determined by the Comptroller, one of whom shall reflect the interests of public employees and one of whom shall reflect the interests of public employers. Each committee member will be both financially literate and unaffiliated, and at least one member will be a financial expert.

For the purposes of the Charter, “financial expert” shall have the same meaning as set forth in the SEC Final Rules regarding Audit Committee Financial Experts under Section 407 of the Sarbanes-Oxley Act of 2002.

As used in the Charter, “financially literate” shall mean that Committee members possess:

- ◆ A general understanding of generally accepted accounting principles, governmental accounting standards and financial statements,
- ◆ Familiarity with the checks and balances that internal controls and corporate governance processes should provide, including an understanding of internal controls and procedures related to financial reporting,
- ◆ The ability to understand the process of evaluating outside audit firms and monitoring their independence and performance, and
- ◆ An understanding of audit committee functions.

COMMITTEE ON INVESTOR RESPONSIBILITY

TASK FORCE RECOMMENDATION

The Task Force recommends that the Committee on Investor Responsibility be disbanded and that OSC staff, together with consultants and other experts, continue to advise the Comptroller on issues relating to corporate governance.

PLACEMENT AGENT FEE DISCLOSURE

INSURANCE DEPARTMENT REGULATION REQUIREMENTS

The Insurance Department Regulations require the following:

In order to preserve the independence and integrity of the fund, to address potential conflicts of interest, and to assist the Comptroller in fulfilling his or her duties as a fiduciary to the fund, the Comptroller shall maintain a reporting and review system that must be followed whenever the fund engages, hires, invests with, or commits to, an outside investment manager who is using the services of a placement agent or intermediary to assist the investment manager in obtaining investments by the fund, or otherwise doing business with the fund. The Comptroller shall require investment managers to disclose to the Comptroller and to his or her designee payments made to any such placement agent or intermediary. The reporting and review system shall be set forth in written guidelines and such guidelines shall be published on the OSC public website.

CURRENT PRACTICE

In order to address the concerns over potential conflicts of interest in the management of Fund assets, one of the Comptroller's first reform measures was to establish and enforce a system for the reporting and review of placement agent fees paid by investment managers in connection with CRF investments. Placement agent fees are fees paid by an investment manager to a placement agent or other intermediary to assist the investment manager in obtaining investments by the Fund or otherwise doing business with the Fund.

As a result of the Policy, no CRF assets can be committed or invested until there is a written disclosure from the potential manager as to whether a placement agent was used in connection with the investment and, if so, whether any fee was paid and the terms of the fee. Such disclosure must be reviewed by a committee made up of the Inspector General of OSC, the Special Counsel for Ethics for OSC and the Chief Investment Officer of CRF.

The new disclosure and review requirements ensure that inappropriate payments or conflicts of interest related to a transaction are identified. Although CRF does not pay such fees and has no requirement or preference as to whether managers use third parties to help secure investments, the new requirements add effective accountability and transparency to the investment process.

Because of the importance of this policy, the Consultant and the Task Force were asked to review and comment on the policy. The Consultant opined that CRF's current policy for Placement Agents is representative of best practice and that, in its opinion, no other public pension fund that it has studied has addressed this topic with more care and diligence than CRF. The Consultant also opined that CRF's policy appears to be fully consistent with the Insurance Department Regulations.

TASK FORCE RECOMMENDATION

The Task Force recommends that the Placement Agent Fee Disclosure Policy, as it currently exists, continue to apply.¹

POTENTIAL CONFLICTS OF INTEREST IN USE OF CONSULTANTS

The Task Force was asked to review CRF's use of consultants and, in particular, to consider the potential conflict if CRF uses a consultant that also manages assets of the Fund. The Consultant was asked to research best practices that would assist CRF in managing any such potential conflict.

¹ The Policy states, in part:

In order to preserve the independence and integrity of the New York State Common Retirement Fund ... and to assist the State Comptroller in fulfilling his duties as a fiduciary to CRF, the Comptroller has established a reporting and review system that must be followed whenever the Fund (directly or indirectly) engages, hires, invests with, or commits to, an outside investment manager ("Investment Manager") that is using the services of a placement agent or other intermediary (collectively, "Placement Agent") to assist the Investment Manager in obtaining investments or providing other intermediary services to the Investment Manager, whether compensated on a fixed fee, contingent fee or other basis. This policy is designed to prevent conflicts of interest or the appearance of conflicts of interest in CRF's investment decision-making process and ensure that investment decisions are made for the sole benefit of CRF's participants and beneficiaries, as well as to ensure the integrity of the CRF decision-making process.

CURRENT PRACTICE

CRF staff acknowledges that there may be a potential conflict in using a consultant that also manages assets of the Fund. Staff's preference is to separate the roles so that its consultants do not manage assets. On the other hand, staff believes that in order to fulfill his fiduciary duty, the Comptroller must be able to use best-in-class consultants.²

To minimize any potential conflict in hiring an existing consultant as a co-investment manager and/or a fund of funds manager, staff has used an independent consultant to assist with the search process, to recommend additional manager candidates and to make a selection recommendation. In addition, CRF staff reviews potential conflicts on a case by case basis when exercising its discretion on ultimate investment decisions.

TASK FORCE RECOMMENDATIONS

The Task Force recommends that the Comptroller continue to seek the best available consultants and, if possible, use consultants that do not manage assets on behalf of the Fund. However, if the Comptroller determines that it is in the best interests of the Fund to choose a consultant that also manages assets, the Task Force recommends that the Comptroller be able to do so.

The Task Force recommends that CRF continue to follow the procedures it currently has in place to manage potential conflicts in these situations. In addition, the Task Force recommends that CRF implement certain additional procedures recommended by the Consultant as being reflective of best practices for large public pension funds. In addition to being reflective of

² The Consultant compiled a league table of the top 20 consultants (by market share) for each of generalist, private equity, real estate and hedge funds. These firms were asked whether they would bid for a consulting role if it would not be permitted to manage assets for CRF. It appeared that the universe of available consultants became substantially restricted if this condition were imposed in private equity and real estate.

best practices, certain of these additional procedures will assist in reducing potential conflicts, or minimizing the likelihood that conflicts will occur.

The following additional procedures are recommended:

Review by IAC or REAC, as appropriate.

If a consultant is potentially conflicted (i.e., manages assets), staff should disclose such potential conflict to IAC or REAC, as appropriate, for its review. Such disclosure should include a statement as to why retention of the consultant is in the best interests of the Fund.

Periodically review the mix of consultants.

At least once every four (4) years, the Fund should review its current group of consultants and make a written report to the Comptroller as to the adequacy of the arrangements and/or suggestions for adjusting the mix of consultants to the Fund.

Purchase investment manager research.

Staff should have access to the forward-looking (i.e., intended to be predictive), qualitative, subjective investment manager research of one or more consultants with strong manager research capabilities. The Task Force recognizes that the usefulness of the access may differ depending upon asset class and that staff should purchase such research selectively.

Separate manager selection and monitoring roles from generalist, strategic advice roles.

The Task Force recommends separating the manager selection and monitoring role in a particular asset class from the generalist, strategic advice role in those asset classes. The Task Force recognizes that this recommendation may not apply to each asset class and that CRF will examine application of this option on a case by case basis.

Maintain a “pool” of pre-qualified consultants for special project work.

The Task Force recommends maintaining a “pool” of consultants that have been pre-qualified, and with which contracts have been signed, to permit them to bid for and conduct special project work as and when needed. The Task Force also recommends that in choosing consultants, staff should attempt to ensure that there is at least one consultant in the pool that does not have a money management business, or that commits to doing consulting work if it is not permitted to manage assets for CRF.

Utilize the pool of consultants as a “strategic sounding board”.

The Task Force recommends that, on an as-needed basis, CRF administer the pool of consultants as a panel – i.e., pose questions or seek opinions of all consultants in the pool in order to benefit from a diversity of experience and views. The Task Force does not believe that CRF needs to retain additional consultants outside of its current pool for this purpose.

EXPANDED COMPLIANCE ROLE

CURRENT PRACTICE

There is a compliance officer within PICM, reporting to the Assistant Comptroller for PICM.

TASK FORCE RECOMMENDATIONS

The Task Force recommends the following:

- ◆ The Compliance function should report to the Deputy Comptroller for Retirement Systems so as to have a distinct reporting line that is independent of investment and front office functions.
- ◆ Compliance staff, currently consisting of one person, should be expanded to mitigate key-person risk and provide additional resources.

TRANSPARENCY

CURRENT PRACTICE

The Comptroller has taken several steps to increase transparency since taking office, including instituting the publication of monthly transaction reports setting forth details of each investment transaction such as the commitment of capital to an investment manager or general partner, including whether a placement agent fee was paid and, if so, the identity of the placement agent. The Consultant found that CRF is among the leaders of its peer group with respect to transparency.

TASK FORCE RECOMMENDATIONS

While the Task Force does not believe that CRF needs to make significant changes to its practices, the Task Force believes that CRF should consider implementing certain additional practices, as follows:

1. Publishing a record of all proxy votes. While the Fund publishes its proxy voting guidelines and the Comprehensive Annual Financial Report lists key votes, additional transparency would be gained by publishing a full list of proxy votes at least once per year.
2. Publishing performance figures on no less than a semi-annual basis. Although CRF is not subject to open meeting laws, additional transparency could be gained by publishing an interim performance statement containing overall Fund performance and asset allocation. The Task Force notes that such returns would be preliminary and unaudited, may not necessarily be arrived at in a manner comparable to that used to arrive at the performance numbers contained in the CAFR, and are subject to adjustment as a result of the year-end audit. The Task Force recommended that the interim performance statement be qualified appropriately. The Task Force believes that any interim performance

report should be published after the information is shared with the Investment Advisory Committee.

The Task Force notes that CRF is in the process of implementing the publication of various policies and procedures and taking other steps to comply with the specific requirements of the proposed Insurance Department Regulations with respect to transparency.

The Comptroller recognizes that additional transparency can be gained by publishing a performance statement containing overall Fund performance and asset allocation more often than once per year, and has already implemented quarterly performance of Fund results, which is more frequent than the minimum recommended by the Task Force.

INVESTMENT POLICY STATEMENT

INSURANCE DEPARTMENT REGULATION REQUIREMENTS

The Insurance Department Regulations require the following:

The fund shall at all times be under the control of the Comptroller, who shall adopt an investment policy statement and any amendments to such as needed. Key elements of an investment policy statement shall include, without limitation:

- 1. investment purpose,*
- 2. investment objectives,*
- 3. roles and responsibilities of the Comptroller, and the Comptroller's staff and committees, with respect to investments of the assets of the fund,*
- 4. investment guidelines and limits encompassing all types of investments,*
- 5. asset allocation targets, including procedures for rebalancing,*
- 6. standards for measuring investment performance and evaluating investment risk, and*
- 7. any other guidelines adopted by the Comptroller with respect to specific investment related issues, including, but not limited to, securities lending, proxy voting, brokerage, and securities litigation.*

CURRENT PRACTICE

CRF currently has a policy statement containing general investment policies, attached to which is an appendix containing the current asset allocation for the CRF. The policy statement also references other detailed policy and procedure documents and guidelines for specific investment categories.

The Consultant reviewed such documents and concluded that CRF's policy statement, on a stand alone basis, does not contain three of the seven key elements required by the insurance regulations; however, when taken together with all of the other CRF Policies and Procedures currently in place, does cover all key elements. The Consultant's research also revealed that best practices among CRF's peers support somewhat greater detail and breadth in a policy statement and suggested several amendments to CRF's current documents. Such amendments will result in a policy statement that is consistent with best practices among peers and which, on a stand alone basis, is consistent with the requirements of the Insurance Department Regulations. Such amendments would not compromise the confidentiality of CRF's strategic plans and internal procedures.

TASK FORCE RECOMMENDATIONS

The Task Force made the following recommendations with respect to the Investment Policy Statement:

1. Incorporate a separate section in the policy statement that expands on the investment objectives and purpose of the Fund, and provides specificity as to expected investment return, time horizon over which results are to be evaluated against the return objective, and amount of acceptable risk.
2. Incorporate an asset allocation and rebalancing policy and documentation that include the asset allocation process in the policy statement. This can be done by summarizing CRF's current separate Asset Allocation and Rebalancing policies and procedures document. In addition, the summary should include the procedures taken to determine the current asset allocation and steps on rebalancing to target allocations.
3. Incorporate summaries of the standards of measuring the performance of investments currently contained in separate policies and procedures documents for each asset class into the policy statement, while leaving operational and procedural matters in the separate documents.
4. Maintain separate policies and procedures that address securities lending, proxy voting, brokerage and securities litigation, and only reference them in the policy statement.

PROCUREMENT

The Insurance Department Regulations provide:

The Comptroller shall establish transparent procurement guidelines and procedures with respect to procurement of all investment managers, and consultants or advisors. Such guidelines and procedures shall be published on the OSC public website. The method of selection of investment managers, and consultants or advisors shall be documented in writing, in a procurement record.

TASK FORCE RECOMMENDATIONS

The Task Force recommends that CRF maintain its own procurement practices and should establish a formal Procurement Policy that is posted on the web site and outlines principles, policies and procedures.

- ◆ The Procurement Policy implemented by CRF should incorporate the following broad policy objectives, consistent with State Finance Law:
 - a. Ensuring that opportunities are made known to the universe of potential bidders;
 - b. Using a document that describes in as much detail as possible CRF's needs and the processes and criteria used to make a selection; and
 - c. Controlling communication between interested vendors and CRF staff to ensure all vendors are on a level playing field.

- ◆ The processes and type of documentation will vary depending on the type of procurement, with the most formalized being an RFP. A Procurement Manual should set forth the requirements for the various types of procurements. As with State procurements, CRF procurements should generally follow a competitive process and contracts should be awarded following a pre-established evaluation process.
- ◆ Staff's outline of different categories of procurements and related requirements fulfill the goals of integrity and consistency, while leaving enough flexibility to accommodate various market opportunities and other considerations.
- ◆ The formal Policy should be a "living document" as vendor capabilities and the nature of required services will evolve over time. In addition, feedback from vendors and staff post-procurement may lead to improvements to procedures. Therefore, amending procurement procedures should be expected and should not be difficult to do.
- ◆ While it is best practice and a requirement of the Insurance Department Regulations to have a formal Procurement Policy, the Policy must contain an affirmative statement that the Comptroller retains the authority to do what he deems necessary to fulfill his fiduciary obligations as the sole trustee of CRF.

INVESTMENT DECISION MAKING

The Task Force was asked to review CRF's internal decision making processes and the role of the advisory committees to CRF in order to ensure that they reflect best practices and constitute a robust mechanism for advising the Comptroller.

As a result of its review, the Task Force made a recommendation to implement an internal investment committee to further strengthen such processes, and to serve as an additional check against the possibility of improper influence on investment decisions. The Task Force also recommended various steps that the Comptroller might take to enhance the role of the current external Investment Advisory Committee, including broadening the scope of the matters upon which the Committee would be consulted.

INTERNAL INVESTMENT COMMITTEE

TASK FORCE RECOMMENDATION

The Task Force recommends that the investment function at CRF include an internal committee, to be called the Investment Committee (IC).

Furthermore, the Task Force suggests the membership and functioning of the IC be designed as follows:

- ◆ The IC would consist of the Chief Investment Officer (CIO) and the most senior investment officers such as the heads of the asset classes. Membership should be at least three persons. The CIO should propose the members of the IC and the Comptroller should approve its initial composition and changes to its membership. The CIO should serve as Chair of the IC.

- ◆ The IC should also have a designated Vice-Chair who in the event of the CIO's absence would lead the meetings.
- ◆ Except for real estate issues that are dealt with by CRF's Real Estate Advisory Committee, no investment allocation decision (including the hiring of investment managers and asset allocation changes) should rise to the consideration of the Comptroller unless reviewed by the IC.
- ◆ The IC should be authorized to act on an exceptional basis (i.e., when time is of the essence and lack of action may place the fund at risk) in the absence of the CIO and the Deputy CIO, subject to super-majority voting by a quorum of its full membership.
- ◆ Minutes will be kept of the IC discussions, and will be included in the package of materials presented to the Comptroller for decision-making.
- ◆ The CIO will ensure that recommendations to the Comptroller are accompanied by minutes of the IC meeting at which the transaction and/or decision was presented, and that the final investment recommendation memo to the Comptroller contain a discussion of the risks of the proposed course of action as well as the factors mitigating risk, as raised and discussed at the IC meeting.
- ◆ The CIO should retain authority to bring urgent issues, or issues that are particularly sensitive or require an exceptional level of confidentiality, directly to the Comptroller without involving the IC.
- ◆ The CIO should make the Comptroller aware of instances in which she/he is recommending action without IC involvement.
- ◆ The CIO will report to the IC on these transactions on an "after-the-fact" basis.
- ◆ CRF will adopt Policies and Procedures for the IC, which shall set forth, among other things, the persons who must receive copies of the IC minutes.

INVESTMENT ADVISORY COMMITTEE

Under the New York State Retirement and Social Security Law, the Comptroller is required to appoint the Investment Advisory Committee to CRF, which 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...

The Task Force was asked to recommend steps to revitalize and further strengthen the existing Investment Advisory Committee.

TASK FORCE RECOMMENDATION

The Task Force recommends that the Comptroller take steps to revitalize the IAC by implementing the following actions:

- ◆ Appoint a strong Chair with a commitment to a dynamically functioning IAC.
- ◆ If practicable, appoint a Vice-Chair, ideally with investment and management experience that complements that of the Chair.
- ◆ Maintain a draft agenda for upcoming IAC meetings that covers at least the next year and review these as a standing agenda item in each meeting.
- ◆ Have staff propose the agenda, but with review, input and signoff, separate from the meetings, by the Chair.
- ◆ Hold pre and post meeting calls that include the Chair and Vice Chair (if any):

- The purpose of the pre-meeting call is to preview the key issues and deliverables for the next meeting, so that questions and areas for focus can be better identified and prepared for by staff and consultants.
- The purpose of the post-meeting call is to identify any issues raised at the meeting that require follow-up, including issues that may trigger changes to agenda for upcoming meetings.
- ◆ Invite CRF consultants to attend and assist staff in presenting at IAC meetings for relevant agenda items. The generalist consultant should attend all IAC meetings and be available to help inform and support discussions. Fund Counsel should also be present and available.
- ◆ Add annual review of the strategic plan of each asset class to IAC's responsibilities. In addition, once a year, the IAC Chair should prepare an internal statement commenting on the strategic plans, documenting among other things that IAC was given the opportunity to provide input into the plans and to review them before they were finalized.
- ◆ Add ongoing monitoring of the program's asset allocation, along with the program's active risk profile to IAC's responsibilities. In addition, IAC should review the program's asset allocation on an annual basis and recommend changes, or confirm that no changes are recommended at that time. These efforts should be facilitated by data provided by the investment staff.
- ◆ Authorize IAC to review CRF's Investment Policy Statement and offer advice regarding amendments as needed.
- ◆ Encourage staff to work at developing informal interaction and idea exchange – an active, two-way dialogue – with individual IAC members.

- ◆ Encourage IAC members to propose ideas for investigation by staff – strategic ideas as well as individual manager names – to increase the likelihood of developing a meaningful two-way dialogue.
- ◆ The Comptroller should develop a simple one paragraph statement expressing his expectations for the IAC. Such statement should acknowledge that IAC is an advisory, not a decision-making body. The Comptroller may also adopt procedures governing IAC.
- ◆ Ideally, IAC members will have broad, strategic-level investment expertise, as opposed to having narrow, niche expertise. For example, former heads of investment-decision making for pension plans, foundations, endowments, etc., will tend to have a more useful perspective than a mutual fund portfolio manager or a securities analyst.

INDEMNIFICATION OF REAL ESTATE ADVISORY COMMITTEE

TASK FORCE RECOMMENDATION

The Task Force believes it would be prudent, reasonable and in the best interest of beneficiaries for the Retirement System to purchase insurance to protect REAC members from liability arising out of their service on REAC, based upon the CRF position that this is necessary to retain and recruit the most qualified volunteers to serve on REAC. Therefore, the Task Force recommends that the Retirement System pursue purchasing insurance, assuming reasonable terms can be negotiated with an insurer for a level of coverage acceptable to the Retirement System.

The Comptroller also should seek legislation to authorize indemnification for REAC members consistent with provisions of the Public Officers Law.

“Comptroller DiNapoli was handed some very serious challenges when he took office. But his commitment to the Task Force and the work we’ve done has helped strengthen his ongoing efforts to restore the public’s confidence in this important government office. I’m proud of the work the Task Force has completed, and I am confident that the Task Force’s recommendations will enhance transparency and improve the investment process on behalf of every New Yorker.”

Shannon O’Brien
Task Force Chair

INDEPENDENT CONSULTANT

The Comptroller decided that the Task Force should be assisted by an experienced, independent consultant to ensure that first, the Task Force would have the resources it needed to research best practices among peers, and second, to ensure that its review process be conducted in an unbiased manner.

In April 2008, as the result of a competitive procurement process, and with the input of the Task Force Chair, the Comptroller and OSC staff selected and retained Mercer Investment Consulting, Inc. (the “Consultant”), to assist the Task Force in its mission.

The Consultant is an international consulting firm that has extensive experience in advising on pension plan governance, and counts among its clients several of the largest U.S. public pension funds. The Consultant has specific experience working with both pension funds that operate with a sole trustee model and others that have relative comparability to CRF in size and structure.

The Consultant was asked to do the following under the direction of OSC staff and the Task Force:

- ◆ review the operations, policies and procedures of CRF;
- ◆ identify best practices of CRF's peer group (as defined below);
- ◆ identify instances where CRF's operations, policies and procedures meet or exceed such best practices;
- ◆ identify instances where CRF's operations, policies and procedures could benefit from such best practices;
- ◆ identify other instances where CRF can make improvements to be consistent with high ethical standards and/or to avoid conflicts of interest;
- ◆ recommend methods for implementing various aspects of the Regulations; and
- ◆ advise as to whether CRF current and/or recommended operations, policies and procedures are consistent with the Insurance Department Regulations.

IDENTIFICATION OF PEER GROUP

Before beginning its research, the Task Force asked the Consultant to define the peer group with which CRF should be compared when reviewing best practices, considering first, that CRF is the third largest public State pension fund in the United States, and second, that CRF is a sole trusteeship. The Consultant included in the peer group all funds with a sole fiduciary (Connecticut, Michigan, North Carolina and the UN Joint Staff) or a handful of ex officio trustees (State Board of Administration of Florida). Next, the Consultant identified 11 other public pension funds that it viewed as being relevant peers to CRF as relates to government structure.

The Consultant's methodology included obtaining all documents in the public domain, and interviewing staff of the selected funds.

Sole Trustee Systems

- ◆ Florida State Board of Administration (SBA)³
- ◆ North Carolina Retirement System
- ◆ Michigan Bureau of Investments
- ◆ United Nations Joint Staff Pension Fund (UNJSPF)
- ◆ State of Connecticut Retirement Plans and Trust Funds (CRPTF)

³ listed twice – SBA has 3 ex-officio trustees

Other Large Institutional Funds

- ◆ Government Pension Fund – Norway
- ◆ ABP – Netherlands
- ◆ California Public Employees (CalPERS)
- ◆ Florida State Board of Administration (SBA)⁴
- ◆ California State Teachers (CalSTRS)
- ◆ Teacher Retirement System of Texas
- ◆ Canada Pension
- ◆ New York State Teachers (NY STRS)
- ◆ Ohio Public Employees (Ohio PERS)
- ◆ British Columbia Investment Management Corporation
- ◆ Wisconsin Investment Board (SWIB)
- ◆ Massachusetts Pension Reserves Investment Management Board (MASS PRIM)
- ◆ Ontario Municipal Employees Retirement System (OMERS)

⁴ listed twice – SBA has 3 ex-officio trustees

NEXT STEPS

The Comptroller and CRF staff are committed to continuing the implementation of the Task Force recommendations and the requirements of the Insurance Department Regulations. Key next steps are as follows:

1. Complete implementation of new policies and practices as set forth in the recommendations.
2. Complete implementation of the Insurance Department Regulations.
3. Complete revision of CRF's Investment Policy Statement.
4. Publish required policies and procedures on the OSC web site.
5. Recruit members for, and convene, the Audit Committee.
6. Add a Compliance Officer and other key positions to CRF.
7. Continue an active schedule of internal audits as conducted by OSC's Office of Internal Audit.

8. Reconvene the Task Force in six to nine months to review overall progress in implementation of recommendations and requirements of the Insurance Department Regulations.

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- ◆ And in particular Raudline Etienne, Chief Investment Officer of the CRF, and Dorothy Carey, Chief Administrative Officer of the CRF, who served as the lead staff assisting the Task Force.