



City of Phoenix

Mission Statement

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

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Retirement Department Investment Policy Statement Compliance

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Report Highlights

Oversight and Standards

The Investment Policy Statement aligned with industry standards.

Conflicts of Interest

All 39 Retirement investment managers and consultants had filed conflicts of interest disclosures with a government regulator or had provided a disclosure to the investment consultant.

Asset Allocations

Some Retirement System funds were invested in an asset class that was not included in the Investment Policy Statement asset allocation plan.

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Executive Summary

Purpose

Our purpose was to determine that the Retirement Office (Retirement) complied with its Investment Policy Statement (IPS).

Background

The City of Phoenix Employees' Retirement System (COPERS) is a single-employer, defined pension plan established by Chapter XXIV of the City Charter. The purpose is to provide pension, disability, and survival benefits to its members. As of November 30, 2023, the total market value of COPERS funds was approximately \$3.4 billion. An IPS is a formalized business plan for investment portfolio that serves as a key guiding document for advisors and investment managers. It describes the roles of all those involved in the investment process and includes discussion on asset allocations.

Retirement staff collaborates with investment consultants Meketa and Aksia for guidance on general and real estate investments. Staff, consultants, and about 39 external investment managers are responsible for overseeing all aspects of investment activities. These activities include assisting the Retirement Board (Board) in hiring new managers, issuing capital calls, and rebalancing portfolios when allocations fall outside of certain levels. Investment performance reports are presented to the Board on a monthly and quarterly basis. Staff reconcile these reports to account statements from the custodian bank.

The Uniform Prudent Investor Act (UPIA), Chartered Financial Analyst (CFA) standards, and the Center for Fiduciary Studies (Fi360) provide best-practices in investment oversight and the development of a sound IPS. The UPIA provides legal framework for fiduciaries (Boards, trustees, and advisors) to follow for managing portfolio investments prudently. The CFA is a respected professional designation for investment and portfolio professionals, setting the standards for ethical behavior and industry practices. The Fi360 serves as a guide for individuals responsible for managing or administering portfolio assets.

We assessed the IPS for its alignment with industry standards and evaluated the Board's oversight practices. This included reviewing policies for manager conflict of interest disclosures and investment portfolio reporting requirements. We also tested the fund for compliance with the IPS asset class target allocations.

Results in Brief

The Investment Policy Statement aligned with industry standards.

We tested a sample of 11 components of the IPS against best-practices as indicated in Fi360, UPIA, and CFA. These components include sections on investment objectives, diversification, conflicts of interest, and asset allocation. We verified that the IPS

contained all 11 components and aligned with industry best-practices for investment management.

The IPS requires that the Board review the IPS annually. Retirement and Law staff indicated that the Board reviews the IPS asset allocation plan annually in February or March. We reviewed the Board meeting minutes for FY2020-23 and found several occurrences where the Board reviewed or amended the IPS Asset Allocation plan.

All 39 investment managers and consultants had filed conflicts of interest disclosures with the U.S. Securities and Exchange Commission (SEC) or had provided a disclosure to COPERS's investment consultant.

The IPS requires that investment consultants and managers involved in the investment process to disclose all relationships that could potentially lead to a conflict of interest. We reviewed the SEC filings for the 39 investment managers and consultants and found that all but one had filed forms that addressed material conflicts of interest and other disclosures related to participation or interest in client transactions. Retirement advised it is the investment consultants' obligation to perform these due diligence checks during the search and selection of potential investment managers. However, the COPERS' policy manual did not clearly define the consultants' requirement to perform and document investment manager due diligence checks.

Retirement System funds were invested in an asset class that was not part of the Investment Policy Statement allocation plan.

Appendix B – Asset Allocation Targets (Appendix B) of the IPS lists the approved asset classes with the prescribed target and range allocations. The Appendix B covering 2017 through February 2023 did not include the Global Tactical Asset Allocation (GTAA) asset class. COPERS' assets were invested in GTAA asset class for the entire period we reviewed, January 1, 2020 to November 1, 2023. Staff explained that during this time GTAA provided favorable returns, had relatively low fees, and was a good holding place for funds while they worked to secure new investment manager contracts. In March 2023, the Board approved an update to the IPS which included listing the GTAA asset class in Appendix B as well as a note indicating that they intend to transition away from the GTAA asset class.

Department Responses to Recommendations

Rec. #2.1: Update Policy 103 of the COPERS Policy Manual to include the investment consultants' requirement to perform and document its due diligence, including conflicts of interest reviews, in the search and selection of investment managers. In addition, update the IPS *Section IV Investment Constraints (B) Prudence, Ethics, and Conflict of Interest* to reference Policy 103.

Response: Retirement agrees to the recommendation and will update Policy's 103 and 154 at the next scheduled Charter Amendments/Policies and Procedures Subcommittee meeting (which are only called as needed.)

Target Date:
Complete

Rec. #3.1: Update Section XI, Forbidden Assets and Strategies of the Investment Policy Statement to align with current investment plans.

Response: Retirement agrees to the recommendation and will update Policy 154 at the next scheduled Charter Amendments/Policies and Procedures Subcommittee meeting (which are only called as needed.)

Target Date:
Complete

1 – Oversight and Standards

Background

The Board oversees the fiscal and managerial operations of COPERS as mandated by Chapter XXIV of the City Charter. As part of this oversight, the Board is responsible for establishing a well-defined IPS to ensure the success of the retirement pension plan. The IPS is found under Policy Number 154 of the COPERS Policy Manual. *IPS Section VIII Review of Investment Policy, Asset Allocation, and Performance* requires that the Board to review the IPS and asset allocations, at least annually, to ensure that the objectives and constraints remain relevant.

The Uniform Prudent Investor Act (UPIA), Chartered Financial Analyst (CFA) standards, and the Center for Fiduciary Studies (Fi360) provide guidance and standards for a well-developed IPS. These standards are the leading benchmarks and are considered guidelines for fiduciary best practices. The Fi360 and CFA include IPS guidance on the following general areas 1) rules and responsibilities, 2) risk/return/time horizon, 3) asset rebalancing, and 4) investment costs.

We reviewed the IPS statement and discussed oversight processes with Retirement staff. We reviewed the Board meeting minutes for FY2023 to verify the annual IPS review. In addition, we compared the IPS to industry standards to ensure it aligned with best practices.

Results

The Board reviewed the investment performance reports which provide indicators of compliance with the IPS.

We obtained Board packet materials for FY2021-23 and meeting minutes for FY23. Retirement staff advised that major changes to the IPS are infrequent. We reviewed two FY23 Board meeting minutes and five monthly and quarterly investment performance reports from the Meketa and Aksia. These reports included investment details and if the assets fall within the IPS investment strategy. We verified that on March 2, 2023, the Board adopted a revision to the IPS investment strategy section; therefore, the Board reviewed the IPS in 2023. Retirement staff indicated that there is a standing Calendar of Events in February or March of every year for the Board to review the Asset Allocation Plan of the IPS. In addition, we reviewed the Board meeting minutes for FY2020-23 and found several occurrences where the Board reviewed or amended the IPS Asset Allocation plan.

Key components of the IPS aligned with UPIA, CFA, and Fi360 standards.

We evaluated 11 key components of the IPS against the standards recommended by Fi360, UPIA, and CFA for achieving investment goals and proper oversight. The industry standards note that an IPS should include discussion on investment objectives,

diversification, conflicts of interest, and asset allocation. We verified that the IPS contained the 11 key elements.

COPERS IPS compared to Industry Standards

COPERS IPS Section	UPIA	CFA	Fi360
Investment Objectives	✓	✓	✓
Diversification	✓	✓	✓
Rules & Responsibilities	✓	✓	✓
Risk & Returns	✓	✓	✓
Liquidity Needs	✓	✓	✓
Tax Considerations	✓	✓	✓
Time Horizon	✓	✓	✓
Conflicts of Interest	✓	✓	✓
Asset Allocation	✓	✓	✓
Delegation of Authority	✓	✓	✓
Investment Costs	✓	✓	✓

The IPS contained the 11 standards for a well-developed investment policy.

In addition, we conducted analysis of the IPS against the CFA and Fi360 guidelines to determine how it aligned to specific investment management practices. The UPIA does not include guidance on this area. We evaluated each of the guidelines recommended for crafting an effective IPS tailored to the needs of each organization. We confirmed that the IPS included detailed specifications for monitoring the investment strategy as prescribed by CFA and Fi360. In addition, the IPS had legal framework for portfolio governance, rules/responsibilities for all involved parties in investment decision making, and policies for rebalancing investments to maintain appropriate allocation.

Recommendation

None

2 – Conflicts of Interest and Reporting

Background

IPS *Section IV Investment Constraints (B) Prudence, Ethics, and Conflict of Interest* states, the Board, staff, investment consultant(s), and investment managers involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions. These parties are required to reveal all relationships that could create or appear to create a conflict of interest in their unbiased involvement in the investment process.

In addition, *Section XIII Reporting Requirements* states that consultants must provide quarterly reports to the Board. These reports include portfolio updates, investment performance benchmarks, and market analysis presentations. The Board uses this information to monitor investment performance and to make decisions on hiring and retaining managers. *Section XIII* also mandates that investment managers submit quarterly reports on their investment-related activities to Retirement staff and the portfolio consultant within 30-days after quarter end. These reports assist staff and the Board in monitoring portfolio performance and ensuring that investment balances align with the custodial bank statements.

The U.S. Securities and Exchange Commission (SEC) regulates investment advisors and provides guidance on reporting material conflicts of interest. The Uniform Application for Investment Adviser Registration (Form ADV) is used as the official application document to register as an investment advisor firm. Part 2 of Form ADV, often referred to as the firm brochure, provides disclosures about the company, its business practices, fees, conflicts of interest, and processes to mitigate possible material conflicts of interest.

We interviewed Retirement and Law staff to understand the procedures for obtaining conflict of interest disclosures from managers. We reviewed SEC filings for the 39 investment managers and consultants. Additionally, we obtained consultant reports and checked for timely submissions.

Results

We confirmed all 39 investment managers and consultants had filed conflicts of interest disclosures with the SEC or had provided a disclosure to the investment consultant.

Retirement and Law staff explained that investment consultants, Meketa and Aksia, perform due diligence reviews of all potential investment managers. Included in this review is the determination and disclosure of any conflicts of interest of the investment managers, as well as a review of the Form ADV and Firm Brochure. Staff reported that if a material conflict of interest is discovered this information is provided and discussed in the presentation of the investment to the Board. This process was not clearly defined

in the IPS *Section IV Investment Constraints (B) Prudence, Ethics, and Conflict of Interest*. However, staff indicated that, Policy 103 of the COPERS Policy Manual, *Purchasing/Rebidding* outlines the investment consultants' duties in the search and selection of investment managers. Staff reported that it would be appropriate to include the investment consultants' due diligence review process for potential investment managers in Policy 103 and reference it the IPS.

We reviewed the SEC filings for the 39 investment managers and consultants and found that all but one had filed a SEC Form ADV. In addition, 32 of the 38 investment managers had submitted a Part 2 Firm Brochure which provided in-depth details on the firm's potential material conflicts and discussion on its conflict mitigation processes. Only one firm, Focus SH Fund, did not have any filings with the SEC. Law staff reported that Focus SH Fund was not registered with the SEC; thus, it would not have an obligation to file any forms with the SEC. Law staff provided documentation of Aksia's due diligence review of Focus SH, which included the disclosure of conflicts of interest.

Consultant and investment manager reports were submitted timely to the Board as required by the IPS.

The IPS requires that consultants provide quarterly reports to the Board. These reports include portfolio updates, investment performance benchmarks, and market analysis presentations. We obtained 15 quarterly and 21 monthly reports from Aksia and Meketa for FY2021-23. We verified that consultants submitted monthly and quarterly reports as required.

Section XIII of the IPS mandates that investment managers submit quarterly reports on their investment-related activities to Retirement staff and the portfolio consultant within 30-days after quarter end. We obtained a list of active investment manager accounts for FY23. We selected ten investment funds and confirmed that they submitted monthly and quarterly reports as required. Three of the tested accounts were not funded during the period under review; therefore, they were not subject to reporting. No exceptions were noted.

Recommendation

- 2.1 Update Policy 103 of the COPERS Policy Manual to include the investment consultants' requirement to perform and document its due diligence, including conflicts of interest reviews, in the search and selection of investment managers. In addition, update IPS *Section IV Investment Constraints (B) Prudence, Ethics, and Conflict of Interest* to reference Policy 103.

3 – Assets and Allocations

Background

IPS *Section XI Forbidden Assets and Strategies* states that each investment manager will be furnished with a list of asset types and investment strategies that are forbidden. *Section VII Asset Allocation (A) Permissible Asset Classes and Appendix A* identify the permissible asset classes that the Board has specifically indicated may be utilized when investing COPERS' assets. *Section VII Asset Allocation (C) Long-Term Target and Appendix B Asset Allocation Targets* (Appendix B), identify the long-term target and range allocations criteria for each asset class. In addition, *Section VII Asset Allocation (D) Rebalancing*, describes the policy for addressing when COPERS' asset allocations fall outside of the target ranges.

We interviewed staff about the processes related to forbidden asset types and strategies. We reviewed asset allocations and consultant reports for a four-year period to determine if asset classes remained within the IPS target allocation range.

Results

Investment managers were not provided with a list of forbidden asset types or investment strategies as required in the IPS.

We met with staff to understand the process for providing investment managers with a list of forbidden asset types and investment strategies. Staff stated COPERS does not maintain an active list of prohibited investments. IPS *Section XI Forbidden Assets and Strategies* policy states that, "Within their investment guidelines, each investment manager will be furnished with a list of asset types and investment strategies that are forbidden."

Retirement staff explained that there were previously restricted asset classes, such as private equity and domestic high yield bonds; however, managers are no longer subject to those restrictions. Staff added that occasionally, the manager contracts and/or side letter agreements include sections that specify certain asset funds or strategies that are restricted. Staff explained that current investment plans cover a broad range of asset classes in which managers are permitted to invest.

We found that COPERS' assets were invested in Global Tactical Asset Allocation (GTAA) asset class which was not part of the IPS asset allocation plan.

GTAA is a top-down investment strategy that is delivered to investors in forms of funds with different underlying assets (mainly cash), managed accounts, total returns swaps, or structured notes. We reviewed Meketa performance update reports from January 1, 2020 through November 30, 2023 (excluding May 2020). In our review, we found that COPERS' assets were invested in GTAA assets from January 1, 2020 through November 30, 2023.

Retirement staff advised that in 2017, an asset class named Real Return was renamed to GTAA. In that same year, the Board approved a new asset allocation plan and GTAA was removed from the IPS Appendix B. Staff explained that GTAA turned out to be a good holding place for funds while they worked to secure new investment manager contracts. They reported that GTAA was earning the Consumer Price Index, plus 5%, which is much higher than the 1 to 2% returns on other short-term investments.

Staff explained that in March 2023, the Board approved an update to Appendix B and added GTAA with a 0% allocation target, and a range of 0 to 5% to signify that the asset class was not part of the approved policy but recognizing that it was not going away any time soon. We reviewed the Meketa performance update reports following the March 2023 IPS update and found that GTAA assets were allocated at 3%, which was within the prescribed 0 to 5% range. In addition, we found that for 2020 through 2022, the GTAA assets had an average allocation of 4%, again under the 5% range.

Retirement staff reported that it can take several months to hire new investment managers and they decided to keep the GTAA account open since it has relatively low fees and produced favorable returns. The Appendix B, notes that Hedge Funds and GTAA strategies will be transitioned off the portfolio as they are not part of the updated asset allocation strategy.

Recommendation

- 3.1 Update *Section XI, Forbidden Assets and Strategies* of the Investment Policy Statement to align with current investment plans.

Scope, Methods, and Standards

Scope

We compared the Retirement Office's IPS to standards and guidelines of Uniform Prudent Investor Act (UPIA), Chartered Financial Analyst (CFA) standards, and the Center for Fiduciary Studies (Fi360). We evaluated the Retirement Board's oversight practices and policies for obtaining manager conflicts of interest and investment reporting requirements. We also reviewed IPS directives on prohibited assets and compared consultant asset allocation reports to the target allocation ranges for FY2020-23.

The internal control components and underlying principles that were significant to the objectives of this audit include:

- Risk Assessment
 - Management should identify, analyze, and respond to risks related to achieving the defined objectives.
- Control Activities
 - Management design control activities to achieve objectives and respond to the risks.
 - Management should implement control activities through policies.
 - Management should design the entity's information system and related activities to achieve and respond to risks.

Methods

We used the following methods to complete this audit:

- We reviewed and tested the policies and procedures for compliance with the COPERS' IPS for oversight, reporting, and forbidden asset disclosures.
- We evaluated the IPS's appropriateness and adherence to UPIA, CFA, and Fi360 standards and guidelines.
- We tested investment consultant and managers contracts, agreements, and SEC filings for conflicts of interest disclosures.
- We reviewed monthly and quarterly performance update reports to verify that asset allocations were compliant with IPS Appendix B Asset Allocation Targets.

Data Reliability

We assessed the reliability of the data in two ways. First, we compared Meketa's cash equivalent update reports with the custodian bank's balance statements. Second, we sampled investment managers' monthly statements and matched them with the

custodian bank's statements. Based on these evaluations, we concluded that the data was sufficiently reliable for the purposes of this audit.

Unless otherwise stated in the report, all sampling in this audit was conducted using a judgmental methodology to maximize efficiency based on auditor knowledge of the population being tested. As such, sample results cannot be extrapolated to the entire population and are limited to a discussion of only those items reviewed.

Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Any deficiencies in internal controls deemed to be insignificant to the audit objectives but that warranted the attention of those charged with governance were delivered in a separate memo. We are independent per the generally accepted government auditing requirements for internal auditors.