

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
Angus Maciver

MEMORANDUM

TO: Legislative Audit Committee Members
FROM: John Harrington, Performance Auditor
DATE: June 2015
CC: David Ewer, Executive Director, Montana Board of Investments
RE: Performance Audit Follow-Up (15SP-06): State Investment Management and Governance Practices (orig. 12P-10)
ATTACHMENTS: Original Performance Audit Summary

Introduction

The *State Investment Management and Governance Practices* (12P-10) report was issued to the Legislative Audit Committee in January 2014. The audit included six recommendations, five to the Montana Board of Investments (board) and one to the Montana Legislature (legislature). In April 2015, we conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

This performance audit identified an opportunity for the legislature to increase the experience requirements for members of the board. The report also included five recommendations to the board to adopt or alter its policies to ensure operational standards are maintained on an ongoing basis. Our follow-up work found the board has implemented three of the five recommendations made in the report and partially implemented another, while the legislature did not implement the remaining recommendation. This memo outlines the steps taken by the board and the legislature in response to each of the six recommendations.

Background

The board is responsible for managing the state's Unified Investment Program and invests all the assets of the state's retirement systems, and those of other state and local government agencies. The board is responsible for management of over \$15 billion in assets on behalf of state and local governments. The board is allocated for administrative purposes to the Department of Commerce. It operates with a staff of approximately 30. The chief investment officer, executive director, and six professional staff serve at the pleasure of the board. The board consists of nine voting members (appointed by the governor and confirmed by the Senate) and two nonvoting legislative liaisons, one each from the Senate and House, from different political parties and appointed by legislative leadership. As a quasi-judicial board, statute requires one of the members to be an attorney, one a member of the Montana Public Employees' Retirement Board and one a member of the Teachers' Retirement Board, and the others to represent small business, agriculture, labor, and the financial community.

Audit Follow-up Results

The following sections summarize the progress toward implementation of the report recommendations.

RECOMMENDATION #1

We recommend the Montana Legislature revise the professional and experience requirements for the composition of the Board of Investments to increase the board’s collective knowledge and understanding of institutional investing.

Implementation Status – Not Implemented

A bill intending to strengthen the qualifications required of certain members of the board was heard and tabled by the House Business and Labor Committee in the 2015 Legislature. In addressing this recommendation, House Bill 347 would have required that three of nine members of the board “must each have at least 10 years of professional investment experience as an investment professional.” Another bill draft, LC0876, entitled “Generally revise laws regarding the Montana board of investments,” was never introduced so it is unclear whether the bill intended to address this recommendation.

RECOMMENDATION #2

We recommend the Board of Investments require ongoing educational activities be provided to board members.

Implementation Status – Implemented

At its February 2014 meeting, the board amended its Governance Manual to read: “Systematic Work and Education Plan – To keep the board and the public informed on a systematic basis on the board’s programs, missions, and responsibilities, the executive director shall submit a Systematic Work and Education Plan formatted as agenda topics for the upcoming board meetings for each calendar year rotating subject matters so that all are covered within a 24-month period to educate, review and in all respects to help board members fulfill their fiduciary role.” A review of agendas and minutes from 2014 and 2015 meetings indicates that the board’s education plan is included and that meetings regularly feature an educational component, including a minimum of two per year by the board’s investment consultant, as well as suggested future topics to address weaknesses of board members and staff.

RECOMMENDATION #3

We recommend the Board of Investments amend its Governance Policy to more strongly emphasize its commitment to annual affirmation of the asset allocation of its entire portfolio of investments.

Implementation Status – Implemented

At its February 2014 meeting, the board voted 8-0 to amend its Governance Manual to emphasize the commitment to annual affirmation of asset allocation of the entire portfolio of investments. In the section addressing asset allocation, the Governance Manual now reads in part, “The board shall review and affirm pension allocation ranges at least annually.” At its November 2014 meeting, the board voted to accept a recommendation from staff to maintain current asset allocation levels.

RECOMMENDATION #4

We recommend the Board of Investments ensure that its regularly required votes, reports and affirmations are adhered to in accordance with its charters.

Implementation Status – Implemented

The board concurred with this recommendation, and implemented it by revising the charters for its three subcommittees to reflect policies it believes are necessary and enforceable. Specifically, at its February 2014 meeting, the board: Amended the Audit Committee Charter to remove a requirement to evaluate the performance of committee members; amended the Loan Committee Charter to include loan and bond committee staff in the completion of certain responsibilities; and struck from the Human Resource Committee Charter a number of previously required reports and evaluations, replacing them with more general language requiring the committee to keep the full board informed without specific timelines or reporting guidelines.

RECOMMENDATION #5

We recommend the Board of Investments adopt a proxy voting policy which provides staff and external managers with sufficient guidance to act in the best interests of account holders and that board members periodically review proxy voting results.

Implementation Status – Partially Implemented

The board's proxy voting policy remains the same as was in place prior to the audit recommendation, and was not strengthened by the board to provide additional guidance to staff and external managers to act in the best interests of account holders. However, meeting agendas and minutes from 2014 indicate that staff addressed the topic with the board, including a robust discussion of proxy voting, an explanation from staff of how proxy voting works, including various options the board has for ensuring the shares it owns are voted appropriately, and several questions and requests for clarification/amplification from board members. At the end of the discussion the board agreed to maintain the current policy, and staff committed to regularly providing the board with updates on proxy voting issues and results.

RECOMMENDATION #6

We recommend the Board of Investments seek revisions to the Montana Procurement Act to provide an exemption to the board for the procurement of external investment management services.

Implementation Status – Not Implemented

The board did not concur with this recommendation when the initial report was issued, asserting instead that it already has statutory authority to acquire external investment management services without following the guidelines of the Montana Procurement Act. Follow-up work indicated the board's position on this recommendation has not changed and no action has been taken or is anticipated.