



PSERB Resolution 2025-09
Re: Womble Bond Dickinson (US) LLP Internal Investigation
Recommendations
January 10, 2025

RESOLVED, that the Public School Employees' Retirement Board (the “Board”) accepts the submission of the Internal Investigation Recommendations submitted by Womble Bond Dickinson (US) LLP and authorizes the Board Chairperson to assign the recommendations to the relevant committees for consideration and adoption.

Post SIP Override Memorandum Internal Investigation Recommendations

Upon completion of Womble Bond Dickinson (US) LLC's Internal Investigation to the PSERS Board of Trustees Audit Compliance and Risk Committee regarding the SIP Override Memorandum, Counsel was requested to provide governance recommendations based on their findings. The importance of governance procedures and protocols cannot be overstated. Proper governance creates a system of checks and balances that ensures PSERS members are receiving secure retirement benefits. Proper governance also builds a culture of transparency and open communication between the staff and Board which allows for appropriate Board oversight. Finally, governance promotes ethical behavior that ensures compliance with all laws and regulations.

The recommendations listed below are provided as suggestions for consideration by the appropriate stakeholders. While many of these changes are operational in nature, we have recommended that the appropriate board level committee review and consider the recommendations in order to ensure adequate governance oversight. We understand that this is consistent with the Audit Compliance and Risk Committee's charter, pursuant to which it is to "Review and make recommendations to the Board on all policies and any amendments governing audit, compliance or risk, with the exception of policies that come within the duties and responsibilities of another Committee." Audit Compliance and Risk Committee Charter, § IV(B)(2).

Further, we note that due to the passage of time from the completion of the investigation to present, some of these proposed recommendations may have already been implemented. For example, we are aware that the Investment Consultant Performance Policy and Procedures were updated in July 2022 and contain a more robust discussion of the valuation and reporting process for the SIP.

Our recommendations are as follows:

- 1. PSERS should subscribe to the daily valuation service from BNYM to permit daily reconciliations.**

At the time of the investigation, BNYM had a daily valuation service which would have obviated this entire issue. For whatever reason, PSERS did not purchase this option. This should be considered by the appropriate stakeholders as it would provide an independent, consistent and more reliable intra-month data source.

The PSERS Finance and Actuarial Committee should consider the appropriate daily valuation service, in accordance with its oversight of financial reporting and controls over financial reporting and processes. Charter of the PSERS Finance and Actuarial Committee, §4(d)(3).

- 2. BNYM should be the primary source. There should be no reliance on internal calculations which create the potential for a conflict of interest and possible human error. All data should be independently verified.**

Staff within the Investment Office’s Operations/Risk group maintained an Excel file to calculate the daily reconciliation of the swap Net Asset Values (“NAV”). It was this internally calculated NAV that was eventually adopted by AON—as the BNYM NAV was considered to be “stale”—when it calculated the revised figures contained in the SIP Memo. Having a PSERS employee determine the daily swap NAVs creates not only the possibility for human error but also creates a potential conflict of interest by having a Portfolio Manager calculate his/her own performance. Counsel did not see any conflict of interest in the NAV calculations in March of 2020. However, since these calculations could potentially have impact on the Risk Share calculation in the future, this procedure should end

However, since the investigation was completed, we understand that all SIP accounts have been moved to NISA Investment Advisors and are managed as an external account. If PSERS continues to independently verify NISA’s information, PSERS should only use BNYM data. We take no position on investment strategy and decisions as this is outside of our area of review.

The PSERS Finance and Actuarial Committee should consider the appropriate controls to avoid conflicts of interest and/or human error in valuation, in accordance with its oversight of financial reporting and controls over financial reporting and processes. Charter of the PSERS Finance and Actuarial Committee, §4(d)(3).

- 3. There should be an ombudsman (or compliance officer) that staff can contact when questions regarding process and procedures occur.**

During our interviews, the Investment staff expressed concern about PSERS’ practice of using self-calculated swaps NAVs. In addition, the staff expressed their frustration in not having access to the daily NAV values from BNYM that were

available. While these concerns were shared amongst themselves, it was clear that the employees were reluctant to voice their concerns to their direct senior management. Having a compliance officer or ombudsman, who has an independent line of report to the Audit Committee available to provide an avenue of communication for these types of concerns would be helpful. Since our investigation, PSERS has created the position of Chief Compliance Officer who will be in a position to react and investigate when concerns are raised.

The Audit, Compliance and Risk Committee should consider whether there are appropriate policies or procedures in place to provide staff members with a mechanism to raise concerns with the Chief Compliance Officer. Audit, Compliance and Risk Committee Charter, § D(3).

4. The Office of Finance and Management should be informed and part of the valuation process, so that there is no perceived conflict of interest in having the Investment Office maintain this data.

During our interviews, it appeared that the Office of Finance and Management (“OFM”) may not have been fully informed or consulted on the SIP valuations issues. It was explained that OFM focused its attention on month and quarter-end valuations, not daily valuations. Since we were unable to interview the CFO, we cannot confirm what information was discussed with that Office. However, there should be a line of communication established between the Investment Office and OFM when issues such as these arise in the future.

Since our investigation was completed, the OFM will be managing the valuation process independently and thereby creating a clear segregation of duties. OFM is currently developing processes and controls for the valuation process.

In alignment with Recommendation No. 3, the PSERS Finance and Actuarial Committee should consider the appropriate controls to avoid conflicts of interest and/or human error in valuation, in accordance with its oversight of financial reporting and controls over financial reporting and processes. Charter of the PSERS Finance and Actuarial Committee, §4(d)(3).

5. The Investment Consultant Performance Policy and Procedures should be reviewed to ensure that it includes a mechanism by which the Audit, Compliance, Risk Committee is advised of deviations from the adopted Policy.

No one on either the Audit, Compliance and Risk Committee or Board were ever made aware of the SIP valuation issue or knew that it was a concern discussed by staff for over 5 months. While the then-CIO did not think the issue required notification to any Board member or committee, it is clear that when the SIP Memo was disclosed to members of the Board, they wanted to know what had occurred and why. There needs to be a clearer and more transparent line of communication between the CIO and the Audit, Compliance and Risk Committee and/or Board.

Currently, OFM and the Investment Office are collaborating on updating the Performance Policy and Procedures.

The Audit, Compliance and Risk Committee should review the updates to ensure alignment with compliance goals and objectives.

6. Reconciliations must be completed in a time-sensitive manner.

The SIP Override Memorandum was completed in October 2020—to memorialize an override of data for March 2020—over 6 months after the swap trades and four months after the fiscal year ended. Data reconciliation should be completed in a time sensitive manner to avoid delays in closing the books. The reconciliation should occur no longer than 4 months after the books are closed. If additional time is needed, the Audit and Compliance Committee should immediately be notified and provided justification for the delay.

The Audit, Compliance and Risk Committee and Finance and Actuarial Committee should consider whether governance changes are appropriate to memorialize reporting reconciliation deadlines and notifications.

7. Any irregularities must be carefully vetted and discussed in a Risk Share year.

The SIP Override Memorandum was being drafted at the same time as the 2020 Risk Share process was underway. Based on the importance of the Risk Share process on the PSERS members, any irregularities during this process need to be reported to and discussed with the appropriate staff and Board committees, including without limitation, the Audit Committee.

The Audit, Compliance and Risk Committee and Finance and Actuarial Committee should consider whether governance changes are appropriate to memorialize reporting reconciliation deadlines and notifications.

8. Revisions should be infrequent and should be clearly identified in published reports.

If future overrides occur for data or reporting that has already been shared with the Board, such overrides or revisions must be immediately identified, marked, and timely disclosed in a clearly identified and labeled revised report. Revisions or deviations from existing benchmarks should be identified in published reports.

If any revisions, modifications or deviations from existing benchmarks occur, these changes should be clearly identified and labeled in revised reports.

The Audit, Compliance and Risk Committee and Finance and Actuarial Committee should consider whether governance changes are appropriate to memorialize reporting reconciliation deadlines and notifications.

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To ensure these operational recommendations, if accepted, are implemented, we suggest a Board Resolution be passed implementing the operational changes. Here is some proposed language for a possible Board Resolution:

The Public School Employees' Retirement Board accepts, in principle, the recommendations made by Womble Bond Dickinson in the **Post SIP Override Memorandum Internal Investigation Recommendations** dated January 2, 2025 and asks the relevant Board

Committees to review and oversee implementation of the proposed recommendations to ensure: the use of independent and consistent data, the use of independent data sources to avoid any appearance of conflicts of interest, full coordination and sharing of information between the finance and investment departments, timely reporting of reconciliations, memorialization of all modifications and deviations from current policies, and notice to the Board, through its committee structure, policy changes, modifications and any deviations from any policies.

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Respectfully submitted,

January 2, 2025

Womble Bond Dickinson (US) LLP
Claire J. Rauscher
Sarah Motley Stone