



# TEXAS PENSION REVIEW BOARD

## INVESTMENT COMMITTEE MEETING

### JULY 14, 2022

TEXAS PENSION REVIEW BOARD

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## TEXAS PENSION REVIEW BOARD

### INVESTMENT COMMITTEE MEETING AGENDA

**Thursday, July 14, 2022 – 3:00 PM**

**Reagan Building, Committee Room 120**

**1400 Congress Avenue, Austin, TX, 78701**

*Committee members may attend this meeting by videoconference pursuant to Texas Government Code §551.127. The officer presiding over the meeting will be physically present at the physical location of the meeting listed above and will preside over the meeting at that location. The meeting will be accessible to the public at the physical location listed above. Access to a livestream of this meeting, agenda materials of the meeting, and a recording of the meeting will be made available at [www.prb.texas.gov](http://www.prb.texas.gov).*

***The Committee may discuss or take action regarding any of the items on this agenda.***

1. Meeting called to order
2. Roll call
3. Committee administrative matters
  - a. **TAB 1** September 29, 2020, meeting minutes
4. **TAB 2** Overview and update on investment-related statutory requirements, including:
  - a. Investment expense reporting under Section 802.103(a), Texas Government Code and 40 TAC Ch. 609
  - b. Investment practices and performance evaluations (IPPE) under Section 802.109, Texas Government Code
5. Updated guidance for conducting IPPEs
6. Future Investment Committee activities
7. Future meetings: agenda items, dates, locations, and other arrangements
8. Invitation for public comment
9. Adjournment

NOTE: The Committee may go into closed session concerning any item on this agenda if authorized under the Texas Open

Meetings Act, Government Code, Code Ch. 551. Persons with disabilities who plan to attend this meeting and who may need special assistance are requested to contact Lindsay Seymour at (800) 213-9425/ (512) 463-1736 three to five (3-5) working days prior to the meeting date so that appropriate arrangements can be made.

TAB 1



**Investment Committee Minutes**  
**September 29, 2020**

1. **Meeting called to order (0:07)**

The Pension Review Board (PRB) Investment Committee meeting was called to order by Chair Christopher Zook on Tuesday, September 29, 2020, at 10:00 a.m. via video- and teleconference.

2. **Roll call of Committee members (0:37)**

Committee Members Present:

Chair Christopher Zook  
Keith Brainard  
Shari Shivers

3. **Roll call of members of the public (0:59)**

There were no pre-registered members of the public.

4. **July 28, 2020, Committee meeting minutes (1:09)**

Chair Zook entertained a motion to suspend the reading of the minutes of the July 28, 2020, meeting of the Investment Committee and approve them as circulated.

The motion was made by Ms. Shivers and seconded by Mr. Brainard.

**The motion passed unanimously.**

5. **Update on Investment Practices and Performance Evaluations as required by Government Code Section 802.109 (SB 322), including: (1:39)**

a. **Reporting compliance as required by SB 322 (1:47)**

Mr. Herbold stated that 50 of the expected 55 Investment Practices and Performance Evaluations (IPPEs) have been received, along with two additional evaluations from systems with less than \$30 million in assets. He updated the committee on the systems that have not yet completed their IPPEs.

b. **Draft report on Investment Practices and Performance Evaluations (3:47)**

Mr. Herbold presented the draft of the agency's Investment Performance Report that is required by statute to be submitted to the legislature. He explained it would include an analysis of the evaluations to identify trends and practices that may be helpful to all Texas public retirement systems. He stated that it would include both recommendations for the legislature and for systems.

**c. Recommended improvements to Investment Practices and Performance Evaluation statute (8:33)**

This item was taken up as part of item 5b.

Mr. Herbold presented potential legislative recommendations for the 87<sup>th</sup> Legislature. He stated that these were based on both legislative intent behind the IPPE requirement and questions that emerged as systems began submitting their evaluations. He stated that the recommendations primarily focus on clarifying what should be included in IPPEs to improve transparency and communicate effectively with stakeholders.

The committee discussed the potential legislative recommendations.

Chair Zook opened the floor to public comments. There were no public comments.

Chair Zook entertained a motion to direct staff to draft potential legislative recommendations for improvements to the Investment Practices and Performance Evaluation statute, incorporating input agreed upon by the committee, for consideration by the full board at its November 12 meeting.

The motion was made by Mr. Brainard and seconded by Ms. Shivers.

**The motion passed unanimously.**

Mr. Herbold presented the additional recommendations to serve as guidance for retirement systems that would be included in the draft Investment Performance report, such as prioritizing passive investments with lower fees, benchmarking returns net of fees as well as gross returns, and documenting the ratio of passive to active investments. He stated that these were not recommendations to the legislature but that the guidance could be educational for systems to learn from each other.

The committee discussed the possibility of making this guidance for systems additional required disclosures because of the potential educational value. The board also discussed the differences between PRB rulemaking and codifying requirements in statute. Anumeha Kumar explained that rulemaking is a more formal process of engaging with stakeholders and creating rules that are more enforceable than informal guidance. The board discussed the extent of the board's rule-making authority for IPPEs. Ms. Kumar stated that staff could discuss options with the PRB attorney general counsel and provide an update on the extent of PRB rulemaking authority in this instance.

Mr. Herbold provided an example of the individual IPPE summaries to be included in the Investment Performance Report.

The committee discussed the best way to present these summaries. It also acknowledged the work of staff to create the summary section which would be a great resource for retirement systems to compare their practices and experiences with other systems.

**d. Updates on correspondence with certain systems regarding concerns with Investment Practices and Performance Evaluations (50:29)**

Mr. Herbold reminded the committee that staff had been asked to follow up with systems that submitted IPPEs that were less detailed or did not include

recommendations. He updated the committee on the communications with systems and their consultants seeking additional details to clarify their IPPEs. He stated that everyone staff spoke to was receptive to making requested changes.

6. **Date and location of next Investment Committee meeting –TBD (52:32)**

Chair Zook stated that the date of the next Investment Committee meeting had not been set. An update will be sent out when the date is set.

7. **Invitation for public comment (52:45)**

There were no public comments.

8. **Adjournment (53:08)**

Chair Zook made a motion to adjourn. The motion was seconded by Mr. Brainard.

**The meeting was adjourned at 10:53 a.m.**

**PRB Staff Present:**

Anumeha Kumar  
Michelle Downie Krane  
Ashley Rendon  
Kenny Herbold  
Bryan Burnham  
James King  
Lindsay Seymour  
Mariah Miller  
Robert Munter  
Wesley Allen

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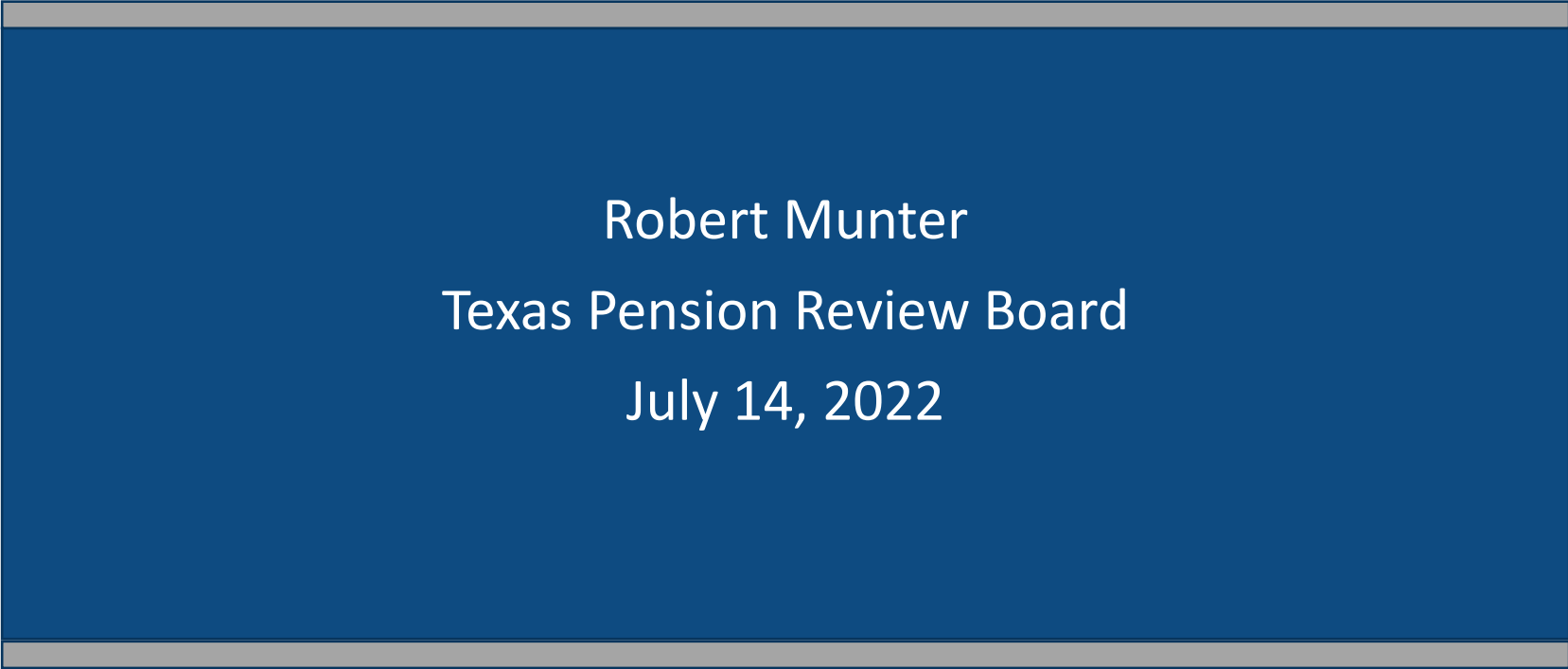
**Chair Christopher Zook**

TAB 2





# Investment Committee



Robert Munter  
Texas Pension Review Board  
July 14, 2022

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# Item 4. Overview and update on statutory requirements

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- a. Investment expense reporting SB 322 (86R)
- b. Investment practices and performance evaluations SB 322 (86R)



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# Legislative and Rulemaking Overview

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Legislature in 2019 passed SB 322 (86R) to improve Texas pension fund investment practices in two ways:

1. Investment expense reporting

- PRB adopted expense reporting rules in 2020 to capture direct and indirect investment fees.
- Increases transparency and allows PRB to make apples-to-apples comparisons between systems.

2. Investment practices and performance evaluations (IPPE)

- PRB adopted IPPE guidance to help systems navigate the statute in performing their first comprehensive evaluation.
- Increases transparency and improves system practices.



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# Investment Expense Reporting Overview

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- New reporting requirements outlined under Texas Government Code §802.103 and Texas Administrative Code §609.111.
- Additional information required to be included in a plan's annual financial report (AFR):
  - A listing of the names of investment managers engaged by the retirement system.
  - A listing, by asset class, of all direct and indirect commissions and fees paid by the retirement system during the fiscal year.
  - A listing, by service provided, of investment services.
- The additional information **must** be in the AFR and not provided in a separate document that accompanies the AFR.
- The information is **not** required to be audited.



# PRB Template Example Adopted 2020

## SB 322 Investment Expense Reporting in Annual Financial Reports - Example

Instructions: This spreadsheet includes tables to assist public retirement systems with investment expense reporting in their annual financial reports as required by Texas Government Code §802.103. The *Direct and Indirect Fees and Commissions* table is intended to assist systems with reporting investment management fees, brokerage fees/commissions, and profit share, as defined by §815.3015(a)(2) of the Texas Government Code. The shaded columns/rows contain built-in formulas to assist with the calculation of total expenses. The Asset Class Categorization Guide, which may be found on the References tab, may be used as a reference regarding how investment types should be classified.

The *Total Investment Expenses* table is provided to help systems report total investment expenses, including investment services, as defined by 40 TAC, §609.105(9). Additionally, the *Alternative/Other* and *Investment Managers* tables are provided to help systems to list investments categorized as alternative/other, as required by 40 TAC, §609.111(i), and the names of investment managers engaged by the system, per Government Code §802.103(a)(4).

Systems are not required to use this format or template to comply with the requirements of Texas Government Code §802.103.

Please be sure to include required investment expense information in the system's annual financial report. It is not necessary to provide a completed template to the PRB.

### Direct and Indirect Fees and Commissions

ASSET CLASS	MANAGEMENT FEES PAID FROM TRUST	MANAGEMENT FEES NETTED FROM RETURNS	TOTAL INVESTMENT MANAGEMENT FEES (Management Fees Netted from Returns + Management Fees Paid From Trust)	BROKERAGE FEES/COMMISSIONS	PROFIT SHARE/CARRIED INTEREST	TOTAL DIRECT AND INDIRECT FEES AND COMMISSIONS (Management Fees + Brokerage Fees/Commissions + Profit Share)
Cash	\$ 1,150	\$ -	\$ 1,150	\$ -	\$ -	\$ 1,150
Public Equity	\$ 5,860	\$ 9,830	\$ 15,690	\$ 20,100	\$ -	\$ 35,790
Fixed Income	\$ 3,460	\$ 6,720	\$ 10,180	\$ -	\$ -	\$ 10,180
Real Assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Alternative/Other	\$ -	\$ 5,260	\$ 5,260	\$ -	\$ 45,100	\$ 50,360
<b>TOTAL</b>	<b>\$ 10,470</b>	<b>\$ 21,810</b>	<b>\$ 32,280</b>	<b>\$ 20,100</b>	<b>\$ 45,100</b>	<b>\$ 97,480</b>

### Alternative/Other

List of Alternative/Other Investments*
Private Equity
Hedge Funds
Commodities

### Investment Managers

List of Investment Manager Names*
XYZ Capital Management
Sample Investments, LLC

### Total Investment Expenses

Total Direct and Indirect Fees and Commissions	\$ 97,480
Investment Services	
Custodial	\$ 8,820
Research	\$ 5,810
Investment Consulting	\$ 10,330
Legal	\$ 5,640
Total	\$ 30,600
	\$ 128,080
Total Investment Expenses (Total Direct and Indirect Fees and Commissions + Investment Services)	



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# Investment Expense Update

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- Fiscal year 2021 is the first year all systems are required to provide investment expense data.
- Remaining AFRs for 2021 are due **July 30**.
- Staff is working with systems to ensure data provided is reasonable and complies with the statute.
- Investment expense data will be added to the new PRB database currently under construction and later pulled to the Data Center.

# Investment Practices and Performance Evaluation (IPPE) Overview

§802.109, Texas Government Code requires public retirement systems with assets of **at least \$30 million** to select an independent firm with substantial experience to:

- evaluate the appropriateness, adequacy, and effectiveness of the retirement system's investment practices and performance and
- make recommendations for improving the retirement system's investment policies, procedures, and practices



# Investment Practices and Performance Evaluation (IPPE) Overview

## Each evaluation must include:

- 1) an analysis of any investment policy or strategic investment plan adopted by the retirement system and the retirement system's compliance with that policy or plan;
- 2) a detailed review of the retirement system's investment asset allocation;
- 3) a review of the appropriateness of investment fees and commissions paid by the retirement system;
- 4) a review of the retirement system's governance processes related to investment activities; and
- 5) a review of the retirement system's investment manager selection and monitoring process.





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# IPPE Timeline to Present

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- First reports were due from systems by June 1, 2020.
- The PRB compiled the received reports into the [Investment Performance Report](#) (IPR) published in November 2020.
- The IPR identified and recommended four changes to the statute in its [Recommendations to the Legislature](#).
- Through HB 3898 (87R) by Anchia, the legislature made several changes to the statute based on the PRB's recommendations, effective September 1, 2021.
- Information now routinely used in intensive reviews.



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# PRB IPPE Recommendations to Legislature

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1. Require evaluations to detail how the evaluator determined the need, or lack thereof, for any recommendations.
2. Require a formal review-and-comment process prior to publication of evaluation reports.
3. Review and consider the feasibility of whether an independent firm conducting the evaluation should be a different firm from the one that helped the system develop its existing investment policies, procedures, and practices.
4. Require evaluators to identify its qualifications and potential conflicts-of-interest; codifying existing PRB informal guidance.



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# IPPE Statute Update

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- IPPEs completed after September 1, 2021, are subject to new disclosure requirements:
  - Statement that independent firm meets experience requirement.
  - Statement for identifying any conflict of interest and relationship with the system.
  - Explanation for a firm's determination regarding whether to include a recommendation or not on each evaluated matter.
- Added formal review-and-comment process to evaluations.
- Sponsor may pay all or part of the cost to prepare the evaluation; system is responsible for the remainder of the cost.
- Systems may continue to use current investment consultants to prepare IPPEs.



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# Subsequent IPPE reports

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- Systems with assets of at least \$100 million must complete an evaluation once every three years.
- Systems with assets of at least \$30 million but less than \$100 million must complete an evaluation once every six years.
- Subsequent evaluations are not required to be comprehensive and can focus on one asset class.



# Item 5. Updated IPPE Guidance



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# IPPE Guidance Document Changes

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- Full document with changes in appendix.
- Summary of updates:
  - 1) Added example timeline of deadlines and updated language.
  - 2) Added language and deadline details for early completion.
  - 3) Added formal review-and-comment process guidance.
  - 4) Updated required disclosures.
  - 5) Added that governmental entity may cover some or all evaluation costs.
  - 6) Differentiate first and subsequent evaluations

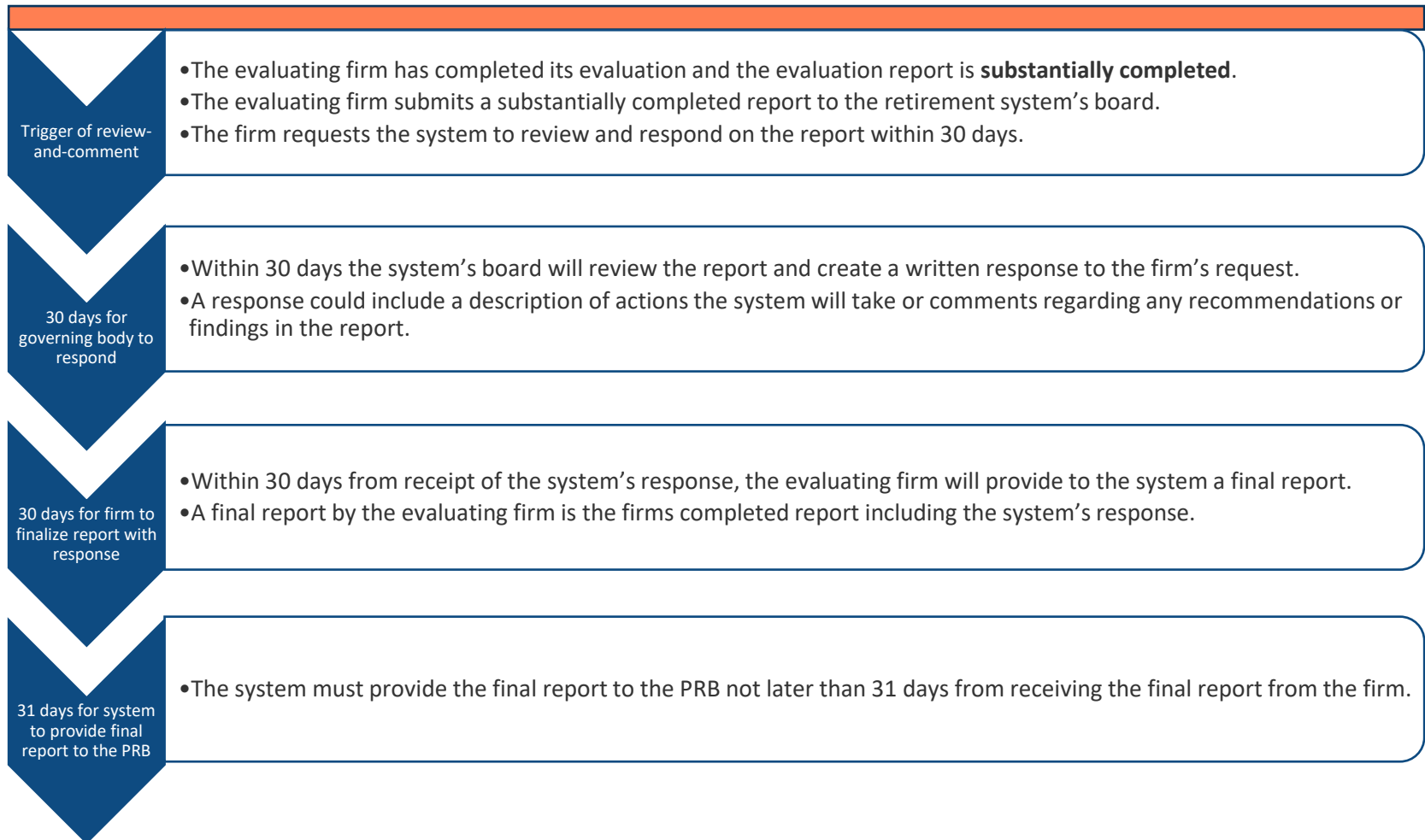
# Deadline updates

- Example timeline and deadlines

Applicable Systems	First Evaluation Due Date	Preparation Recommended Start Date	Evaluation Process Completion Year	Submission to Governing Body and Request Review-and-Comment Target Date	Governing Body Response to Review-and-Comment Due	Final Report to a System's Governing Body Due	Report Due to the PRB
At Least \$100 Million	May 1, 2020	October 2022	2023	March 2, 2024	April 1, 2024	May 1, 2024	June 1, 2024

- Deadline for early completion before June 1, 2024
  - Triggered by a **substantially** completed evaluation report being submitted to the system's governing body.
  - Deadlines then are based on the formal review-and-comment process

# Formal Review-And-Comment Process





# Updated Disclosures

The evaluation **must** include the following disclosures by the independent firm:

- 1) a summary outlining the qualifications of the firm in evaluating institutional investment practices and performances;
- 2) a statement that the firm meets the experience requirements;
- 3) a statement indicating the nature of any existing relationship between the firm and the system being evaluated;
- 4) a statement acknowledging that the firm, or its related entities, is not involved in directly or indirectly managing investments of the system;
- 5) a statement identifying any potential conflict of interest or any appearance of a conflict of interest that could impact the analysis between the independent firm and the system or any current/former member of the system's governing body;
- 6) a list of the types of remuneration received by the firm from sources other than the retirement system for services provided to the system; and
- 7) an explanation of the firm's determination regarding whether to include a recommendation for each of the evaluated matters in the report or a lack thereof.



# Governmental Entity's Ability to Cover Evaluation Cost and Subsequent Evaluations

- A governmental entity that is the employer of the active members for a public retirement system being evaluated may pay for all of part of the costs resulting from the evaluation.
- Any remaining cost not covered by the governmental entity shall be paid by the system.
- Added language in the IPPE guidance so systems and governmental entities are aware.
- Added language in the IPPE guidance to inform systems that the statute allows subsequent evaluations to focus on specific asset classes and does not require all assets to be reviewed.



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# Draft IPPE Guidance Update Feedback

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- The PRB is accepting feedback until **September 16, 2022**.
- Finalized draft will be presented to the board at the October meeting for adoption.

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# Item 6. Future Investment Committee Activities

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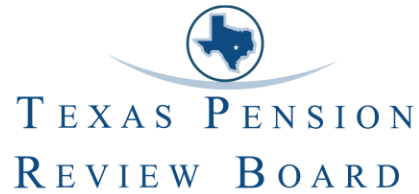
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# Future Investment Committee Activities

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- Finalize updated IPPE guidelines based on committee and stakeholder feedback
- Draft investment-related guidelines and best practices based on criteria in IPPE statute:
  - Investment Policy Statement
  - Asset allocation
  - Investment fees
  - Governance
  - Investment manager selection and monitoring
- Further develop investment expenses and analysis

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## **Guidance for Investment Practices and Performance Evaluations**

(§802.109, Texas Government Code)

~~As required by Senate Bill (86R)~~

~~(Adopted October 17, 2019)~~

[Texas Government Code §802.109](#) requires Texas public retirement systems with at least \$30 million in assets to complete an Investment Practices and Performance Evaluation. The Pension Review Board (PRB) is providing this informal guidance to assist systems in defining the scope and content of the evaluation.

The following provides guidance on the different areas required by statute to be reviewed by the independent firm performing the evaluation. The PRB recognizes that evaluations should and will vary significantly based on the specific characteristics of each system's size, governance structure, and investment program. Therefore, this guidance is intended to inform systems and their stakeholders on the basic aspects of the evaluations and associated reports and is not an exhaustive list of all items that should be reviewed.

### **A thorough evaluation would include the following elements:**

- 1) Identify and review existing investment policies, procedures, and practices. This should include any formally established policies (e.g. Investment Policy Statement) as well any informal procedures and practices used to carry out the investment activities of the system. It is not necessary to review past policies, procedures, and practices that are no longer applicable unless they are deemed helpful to understand current policy or practice.
- 2) Compare the existing policies and procedures to industry best practices.
- 3) Generally, assess whether the board, internal staff, and external consultants are adhering to the established policies.
- 4) Identify the strengths and weaknesses of the current policies, procedures, and practices and make recommendations for improvement.
- 5) Include a detailed description of the criteria considered and methodology used to perform the evaluation, including an explanation of any metrics used and associated calculations.

### **Applicability**

Systems with assets of **at least \$100 million** must complete an evaluation **once every 3 years**.<sup>i</sup> Systems with assets of **at least \$30 million but less than \$100 million** must complete an evaluation **once every 6 years**. Systems with assets **less than \$30 million** are **not required**, but are encouraged, to conduct an evaluation. Systems that have not voluntarily completed an evaluation and have assets less than \$30

million will be required to complete an evaluation if, as of the last day of their preceding fiscal year, their assets exceed \$30 million. Systems completing their first evaluations must conduct a comprehensive review of all invested asset classes while systems conducting subsequent evaluations may select specific asset classes to focus on.

## Deadlines

### Systems that have not completed an evaluation

A report of the first evaluation must be filed with the governing body of the system **not later than May 1** the following year in which the system is either required to be or voluntarily evaluated, ~~2020~~.

**Example timeline and deadlines for a system with assets that first exceed \$30 million in 2022 or a system that decides to voluntarily complete an evaluation in 2023.**

<u>Fiscal Year Assets Exceed \$30 Million</u>	<u>Preparation Recommended Start Date</u>	<u>Evaluation Process Completion Year</u>	<u>Submission to Governing Body and Request Review-and-Comment Target Date</u>	<u>Governing Body Response to Review-and-Comment Due</u>	<u>Final Report to a System's Governing Body Due</u>	<u>Report Due to the PRB</u>
<u>2022</u>	<u>February 2023</u>	<u>2023</u>	<u>March 2, 2024</u>	<u>April 1, 2024</u>	<u>May 1, 2024</u>	<u>June 1, 2024</u>

### Systems that completed an evaluation

Reports of subsequent evaluations must be filed with the governing body of the system not later than May 1 the following year in which the system is evaluated. ~~of the applicable year. Each report is due to the PRB not later than 31 days after~~ the date the governing body of a public retirement system receives it.

### Example timeline and deadlines for subsequent evaluation

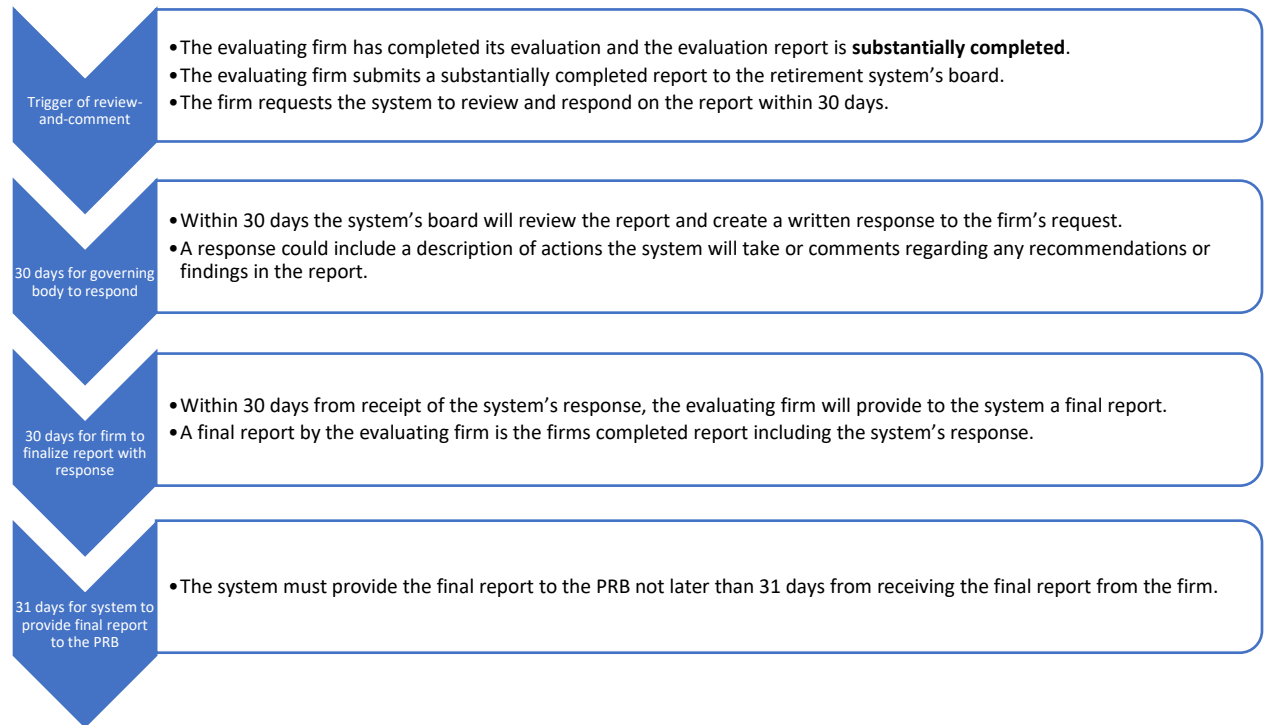
<u>Applicable Systems</u>	<u>First Evaluation Due Date</u>	<u>Preparation Recommended Start Date</u>	<u>Evaluation Process Completion Year</u>	<u>Submission to Governing Body and Request Review-and-Comment Target Date</u>	<u>Governing Body Response to Review-and-Comment Due</u>	<u>Final Report to a System's Governing Body Due</u>	<u>Report Due to the PRB</u>
<u>At Least \$100 Million</u>	<u>May 1, 2020</u>	<u>October 2022</u>	<u>2023</u>	<u>March 2, 2024</u>	<u>April 1, 2024</u>	<u>May 1, 2024</u>	<u>June 1, 2024</u>
<u>First Evaluation Completed in 2020</u>	<u>May 1, 2020</u>	<u>October 2025</u>	<u>2026</u>	<u>March 2, 2027</u>	<u>April 1, 2027</u>	<u>May 1, 2027</u>	<u>June 1, 2027</u>



## Deadline for submission before June 1, 2024

If a substantially completed report is submitted to a retirement system's governing body in accordance with the formal review-and-comment process before March 2, 2024, a final report is **due to the PRB not later than 91 days after the governing body first receives the substantially completed report.**<sup>1</sup>

## Formal review-and-comment process



## Independent firm

*(a) ... A public retirement system shall select an **independent firm** with substantial experience in evaluating institutional investment practices and performance...*

*(c) Provides that a public retirement system, in selecting an **independent firm** to conduct the evaluation described by Subsection (a):*

*(1) subject to Subdivision (2), is authorized to select a firm regardless of whether the firm has an existing relationship with the retirement system; and*

*(2) is **prohibited** from selecting a firm that **directly or indirectly manages investments** of the retirement system.*

## Directly or Indirectly Managing Investments

<sup>1</sup> [§802.109 \(e-1\), Texas Government Code](#)

A firm is considered to be directly or indirectly managing investments if the firm, a subsidiary, or its parent company, has assets of the system under management, or is solely responsible for selecting or terminating investment managers.

### **Restriction on Performing the Evaluation**

If a firm is identified as directly or indirectly managing investments of the system, the firm is not considered an independent firm and is not eligible to perform the evaluation.

### **Required Disclosure by Independent Firm**

The evaluation ~~must~~should include the following disclosures by the independent firm:

- 1) a summary outlining the qualifications of the firm in evaluating institutional investment practices and performance;
- 2) a statement that the firm meets the experience requirements;
- ~~2)3)~~ a statement indicating the nature of any existing relationship between the firm and the system being evaluated;
- 4) a statement acknowledging that the firm, or its related entities, is not involved in directly or indirectly managing investments of the system;
- 5) a statement identifying any potential conflict of interest or any appearance of a conflict of interest that could impact the analysis between the independent firm and the system or any current/former member of the system's governing body;
- ~~3)6)~~ a list of the types of remuneration received by the firm from sources other than the retirement system for services provided to the system; and
- 7) an explanation of the firm's determination regarding whether to include a recommendation for each of the evaluated matters in the report or a lack thereof.

### **Governmental Entity's Ability to Cover Evaluation Costs**

A public retirement system's associated governmental entity may pay for all of part of the costs resulting from the evaluation. Any remaining cost not covered by the governmental entity shall be paid by the system.

- ~~4) a statement acknowledging that the firm, or its related entities, is not involved in directly or indirectly managing investments of the system.~~

## Components of Evaluation

This section provides suggested questions and topics for consideration under each of the five areas required to be covered in each evaluation.<sup>ii</sup> The questions below are intended to help systems identify the types of information an evaluation may include. Additionally, these questions may be helpful to systems that will use a request for proposal (RFP) to select a firm to perform the evaluation.

*Each evaluation must include:*

*(1) an analysis of any **investment policy or strategic investment plan** adopted by the retirement system and the retirement system's compliance with that policy or plan;*

- Does the system have a written investment policy statement (IPS)?
- Are the roles and responsibilities of those involved in governance, investing, consulting, monitoring and custody clearly outlined?
- Is the policy carefully designed to meet the real needs and objectives of the retirement plan? Is it integrated with any existing funding or benefit policies? (i.e. does the policy take into account the current funded status of the plan, the specific liquidity needs associated with the difference between expected short-term inflows and outflows, the underlying nature of the liabilities being supported [e.g. pay-based vs. flat \$ benefit, automatic COLAs, DROP, etc.]?)
- Is the policy written so clearly and explicitly that anyone could manage a portfolio and conform to the desired intentions?
- Does the policy follow industry best practices? If not, what are the differences?
- Does the IPS contain measurable outcomes for managers? Does the IPS outline over what time periods performance is to be considered?
- Is there evidence that the system is following its IPS? Is there evidence that the system is not following its IPS?
- What practices are being followed that are not in, or are counter to, written investment policies and procedures?
- Are stated investment objectives being met?
- Will the retirement fund be able to sustain a commitment to the policies under stress test scenarios, including those based on the capital markets that have actually been experienced over the past ten, twenty, or thirty years?
- Will the investment managers be able to maintain fidelity to the policy under the same scenarios?
- Will the policy achieve the stated investment objectives under the same scenarios?
- How often is the policy reviewed and/or updated? When was the most recent substantial change to the policy and why was this change made?

### Resources

[PRB - Developing an Investment Policy](#)

[GFOA - A Guide for Establishing A Pension Investment Policy](#)

[CFA - A Primer for Investment Trustees](#)

(2) a detailed review of the retirement system's **investment asset allocation**, including:

(A) the process for determining target allocations;

- Does the system have a formal and/or written policy for determining and evaluating its asset allocation? Is the system following this policy?
- If no formal policy exists, what is occurring in practice?
- Who is responsible for making the decisions regarding strategic asset allocation?
- How is the system's overall risk tolerance expressed and measured? What methodology is used to determine and evaluate the strategic asset allocation?
- How often is the strategic asset allocation reviewed?
- Do the system's investment consultants and actuaries communicate regarding their respective future expectations?
- How does the current assumed rate of return used for discounting plan liabilities factor into the discussion and decision-making associated with setting the asset allocation? Is the actuarial expected return on assets a function of the asset allocation or has the asset allocation been chosen to meet the desired actuarial expected return on assets?
- Is the asset allocation approach used by the system based on a specific methodology? Is this methodology prudent, recognized as best practice, and consistently applied?
- Does the system implement a tactical asset allocation? If so, what methodology is used to determine the tactical asset allocation? Who is responsible for making decisions regarding the tactical asset allocation?
- How does the asset allocation compare to peer systems?

(B) the expected risk and expected rate of return, categorized by asset class;

- What are the strategic and tactical allocations?
- What is the expected risk and expected rate of return of each asset class?
- How is this risk measured and how are the expected rates of return determined? What is the time horizon?
- What mix of assets is necessary to achieve the plan's investment return and risk objectives?
- What consideration is given to active vs. passive management?
- Is the approach used by the system to formulate asset allocation strategies sound, consistent with best practices, and does it result in a well-diversified portfolio?
- How often are the strategic and tactical allocations reviewed?

(C) the appropriateness of selection and valuation methodologies of alternative and illiquid assets; and

- How are alternative and illiquid assets selected, measured and evaluated?

- Are the system's alternative investments appropriate given its size and level of investment expertise? Does the IPS outline the specific types of alternative and illiquid investments allowed, as well as the maximum allocation allowable?
- What valuation methodologies are used to measure alternative and illiquid assets? What alternative valuation methodologies exist and what makes the chosen method most appropriate?

*(D) future cash flow and liquidity needs;*

- What are the plan's anticipated future cash flow and liquidity needs? Is this based on an open or closed group projection?
- When was the last time an asset-liability study was performed?
- How are system-specific issues incorporated in the asset allocation process? What is the current funded status of the plan and what impact does it have? What changes should be considered when the plan is severely underfunded, approaching full funding, or in a surplus? How does the difference between expected short-term inflows (contributions, dividends, interest, etc.) and outflows (distributions and expenses) impact the allocation? How does the underlying nature of the liabilities impact the allocation (e.g. pay-based vs. flat \$ benefit, automatic COLAs, DROP, etc.)?
- What types of stress testing are incorporated in the process?

Resources

[GFOA – Asset Allocation for Defined Benefit Plans](#)

[CFA – A Primer for Investment Trustees](#)

*(3) a review of the **appropriateness of investment fees and commissions paid** by the retirement system;*

- Do the system's policies describe the management and monitoring of direct and indirect compensation paid to investment managers and other service providers? What direct and indirect investment fees and commissions are paid by the system?
- Who is responsible for monitoring and reporting fees to the board? Is this responsibility clearly defined in the system's investment policies?
- Are all forms of manager compensation included in reported fees?
- How do these fees compare to peer group and industry averages for similar services? How are the fee benchmarks determined?
- Does the system have appropriate policies and procedures in place to account for and control investment expenses and other asset management fees?
- What other fees are incurred by the system that are not directly related to the management of the portfolio?
- How often are the fees reviewed for reasonableness?
- Is an attorney reviewing any investment fee arrangements for alternative investments?

Resources

[GFOA - Investment Fee Guidelines for External Management of Defined Benefit Plans](#)

[CFA - A Primer for Investment Trustees](#)

(4) *a review of the retirement system's **governance processes related to investment activities**, including investment decision-making processes, delegation of investment authority, and board investment expertise and education;*

Transparency

- Does the system have a written governance policy statement outlining the governance structure? Is it a stand-alone document or part of the IPS?
- Are all investment-related policy statements easily accessible by the plan members and the public (e.g. posted to system website)?
- How often are board meetings? What are the primary topics of discussion? How much time, detail, and discussion are devoted to investment issues?
- Are meeting agendas and minutes available to the public? How detailed are the minutes?

Investment Knowledge/Expertise

- What are the backgrounds of the board members? Are there any investment-related educational requirements for board members?
- What training is provided and/or required of new board members? How frequently are board members provided investment-related education?
- What are the minimum ethics, governance, and investment education requirements? Have all board members satisfied these minimum requirements?
- Does the system apply adequate policies and/or procedures to help ensure that all board members understand their fiduciary responsibilities?
- What is the investment management model (i.e. internal vs. external investment managers)?
- Does the board receive impartial investment advice and guidance?
- How frequently is an RFP issued for investment consultant services?

Accountability

- How is the leadership of the board and committee(s), if any, selected?
- Who is responsible for making decisions regarding investments, including manager selection and asset allocation? How is authority allocated between the full board, a portion of the board (e.g. an investment committee), and internal staff members and/or outside consultants? Does the IPS clearly outline this information? Is the board consistent in its use of this structure/delegation of authority?
- Does the system have policies in place to review the effectiveness of its investment program, including the roles of the board, internal staff and outside consultants?
- Is the current governance structure striking a good balance between risk and efficiency?
- What controls are in place to ensure policies are being followed?
- How is overall portfolio performance monitored by the board?
- How often are the investment governance processes reviewed for continued appropriateness?

## Resources

[NASRA - Public Pension Governance](#)

[PEW - Making State Pension Investments More Transparent](#)

[CFA - Investment Governance for Fiduciaries](#)

[CFA - A Primer for Investment Trustees](#)

(5) a review of the retirement system 's **investment manager selection and monitoring process**.

- Who is responsible for selecting investment managers?
- How are the managers identified as potential candidates?
- What are the selection criteria for including potential candidates?
- What are the selection criteria when deciding between multiple candidates?
- How does the selection process address ethical considerations and potential conflicts of interest for both investment managers and board members?
- Who is responsible for developing and/or reviewing investment consultant and/or manager contracts?
- What is the process for monitoring individual and overall fund performance?
- Who is responsible for measuring the performance?
- What benchmarks are used to evaluate performance?
- What types of performance evaluation reports are provided to the board? Are they provided in a digestible format accessible to trustees with differing levels of investment knowledge/expertise?
- How frequently is net-of-fee and gross-of-fee investment manager performance reviewed? Is net-of-fee and gross-of-fee manager performance compared against benchmarks and/or peers?
- What is the process for determining when an investment manager should be replaced?
- How is individual performance evaluation integrated with other investment decisions such as asset allocation and investment risk decisions?

## Resources

[GFOA - Investment Fee Guidelines for External Management of Defined Benefit Plans](#)

[GFOA - Selecting Third-Party Investment Professionals for Pension Fund Assets](#)

[CFA - A Primer for Investment Trustees](#)

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<sup>i</sup> The Houston Firefighters Relief & Retirement Fund, the Houston Municipal Employees Pension System, and the Houston Police Officers' Pension System may submit the investment evaluation reports in Vernon's Civil Statutes to satisfy the requirements of §802.109.

<sup>ii</sup> The first evaluation "must be a comprehensive analysis of the retirement system's investment program that covers all asset classes" while subsequent evaluations "may select particular asset classes on which to focus."