Educational Session: Governance

TMRS Board of Trustees

August 24, 2018
Today’s Objectives

- Make progress under TMRS Strategic Plan Goal 3, Objective A
  - Goal 3. Identify and implement the best governance and management structure.
  - Objective A. Enhance Board meeting productivity.
  - Identify further drill down topics for discussion and Board focus

- Address PRB Training Requirements so that Board Members can be eligible to receive continuing education credit

- Engage in focused discussion on the topics requested by the Board in the June 2018 Board meeting

- Address, to the extent possible, some topics that would typically be part of an annual Board self-evaluation
Agenda

• What is Governance?
• Governance in a Public Retirement System Context
• The Evolving Role of Public Retirement System Boards
• Oversight of Public Retirement Systems
• TMRS Internal and External Experts
• Board Meeting Effectiveness and Efficiency
• Wrap Up and Open Discussion
General PRB Requirements for Governance Education Courses

• Explain the structure, manner, and processes through which a board exercises authority

• Provide an overview of the types of plan professionals with whom trustees will interact.

• Address:
  − Trustee appointments, terms, and qualifications
  − Role and responsibilities of the Board
  − Laws and rules governing the System
  − Board bylaws, policies, processes, and procedures
  − Best practices for pension plan board governance
  − Delegation of responsibilities while retaining appropriate oversight
  − Strategic planning
What is Governance?
Quick Quiz

Which of the below is governance?

A. Investment Governance
B. Information Technology Governance
C. Contribution Governance
D. Corporate Governance
E. Board Governance
F. All of the above
Defining Good Governance Can be a Challenge

I was just looking for a simple answer.

FROM HARVARD BUSINESS REVIEW, NOVEMBER 2014. CARTOON BY BILL ABBOTT.

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Definitions for Consideration

• Governance is the process of decision-making and the process by which decisions are implemented (or not implemented)\(^1\).

• Governance is the structure, manner and process through which a board exercises authority or control\(^2\).

• *Good governance* is an indeterminate term used in international development literature to describe how public institutions conduct public affairs and manage public resources.

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\(^1\) United Nations Economic and Social Commission for Asia and the Pacific: https://www.unescap.org/sites/default/files/good-governance.pdf

\(^2\) From TMRS New Trustee Orientation Module on Board Governance

\(^3\) Wikipedia: https://en.wikipedia.org/wiki/Good_governance
Quick Quiz

Having good pension fund governance has been found to translate into approximately how much of an investment performance premium?

A. Less than 1% per year
B. Between 1% and 5% per year
C. Between 5% and 8% per year
D. None of the above
Good Governance Matters: Empirical Evidence

The Pension Governance Deficit: Still With Us

By Ambachtsheer, Capelle, and Lum. Published Fall 2008 in the Rotman International Journal of Pension Management.

Spotlight on Pension Governance

A 1999 investigation into the quality of pension fund governance uncovered a well-grounded board competency problem. This follow-up study analyzes the findings of a more recent pension fund governance, to which an international group of 80 senior pension fund executives responded. Survey responses indicate that the board competency problem has not disappeared. In the case. In 1997, we found a positive correlation between governance quality and total performance. The new results also suggest that selection processes for members of the board of governors continue to be high. Self-evaluation of board effectiveness continues to be the exception rather than the rule. Weak oversight functions continue to lead to difficulties in setting out the competing fiduciary interests of different stakeholders, result in organizational dysfunction, and result in a lack of delegation clarity between board and management responsibilities, board/executive management, and non-competitive compensation policies in pension funds. We recommend a number of specific actions to address these governance challenges that continue to face pension funds. We also recommend that regulators require pension funds to regularly report on the actions they are taking to strengthen their governance processes.

By Chris Merker, PhD. Published January 2018 in Benefits Magazine.

By Ambachtsheer, Capelle, and Lum. Published Fall 2008 in the Rotman International Journal of Pension Management.

By Chris Merker, PhD. Published January 2018 in Benefits Magazine.
Essential Principles of Good Governance

• Compliant with the law, specifically high fiduciary standards
• Accountable
• Transparent
• Responsive
• Efficient
• Consensus-oriented
• Inclusive
• Fair
• Knowledgeable and experienced
• Have an appropriate balance of retained and delegated authority
• Others?
No singular playbook comprehensively addresses every type of best practice.

Reputable sources of industry best practices for public retirement systems include, among others:

- Stanford Institutional Investors’ Forum
- NASRA
- NCPERS
- GFOA
- APPFA
- NAPPA
- NASIO
- IPMA-HR
- CFA Institute

“Best practices” become best when they are fit for purpose.
Governance in a Public Retirement System Context
The Roots of Governance for Public Retirement Systems

• Public retirement systems are acts of legislatures.

• For statewide systems, governance involves multiple parties including:
  − The governor.
  − The legislature.
  − The board of trustees.
  − Staff to whom the board has delegated responsibility.

• The structure for how a system is to be governed is found in two critical areas of documentation:
  − One is within the influence, but not within the control, of the board (the law).
  − The other is within the board’s control (by-laws, policies, rules).

• This is one of the biggest differences between a public board and other corporate or non-profit entities.
Laws Applicable to TMRS

• Texas Constitution, Article 16, Section 67

• Select chapters\(^1\) of the Texas Government Code address parameters such as:
  – Board size, composition, and terms
  – Key Board responsibilities Board authority
  – Reporting requirements
  – Plan eligibility, membership, and benefits

• Additional state laws\(^2\) apply to TMRS such as those pertaining to investments, ethics, open meetings, and public records

• Federal laws, such as the Internal Revenue Code and those under the purview of the Securities and Exchange Commission

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\(^1\) Texas Government Code Chapters 851 - 855.

\(^2\) Including Texas Government Code Chapters 801 – 804, 807, Texas Property Code Chapter 117. A complete listing of laws applicable to TMRS can be found at [https://www.tmrs.com/legislative_rules.php](https://www.tmrs.com/legislative_rules.php)
TMRS Governing Policies

- By-laws
- Committee Charters including
  - Audit Committee
  - Advisory Committee on Benefit Design
  - Legislative Committee
- Board-approved Policies including
  - Funding Policy
  - Investment Policy Statement
- Board Rules*

*TMRS Administrative Code, Title 34, Part 6, Chapters 121, 123, 125, 127, 129
TMRS Board Size and Composition

6 Board Seats Provided by Law

All are appointed by the Governor for 6 year terms, subject to Senate Confirmation

3 Executive Trustees

3 Employee Trustees
The median public retirement system board size is 9.
Composition varies widely:
- Appointed
- Elected
- Ex-officio
The average term is 4 years.\(^1\)
Staggered terms are best practice.

\(^1\)National Education Association, “Characteristics of Large Public Education Pension Plans,” 2016
Board Role – Governance Structure Matters

• Generally, public retirement boards are responsible for the administration of the system’s benefits.

• A majority of statewide systems also have responsibility for oversight of investing pension fund assets; approximately 30% do not.
  – For those 30%, investment responsibility is granted to a sole trustee or a separate entity. Examples include:

<table>
<thead>
<tr>
<th>Examples of States with a Sole Trustee</th>
<th>Examples of Statewide Investment Boards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>State of Wisconsin Investment Board</td>
</tr>
<tr>
<td>New York</td>
<td>Massachusetts PRIM</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Minnesota State Investment Board</td>
</tr>
<tr>
<td>Michigan</td>
<td>Washington State Investment Board</td>
</tr>
</tbody>
</table>

Source: Nasra.org
Board Role – Level of Authority Granted Matters

• The type and degree of responsibility and authority of public retirement system boards vary depending upon differences in state law.

• Some systems are agencies of a state while others are instrumentalities of a state.

• What level of authority does a system’s board have relative to:
  - Budget?
  - Personnel?
  - Compensation?
  - Procurement?

• Larger asset size or membership base does equal increased authority.

• The TMRS Board has final approval authority relative to budget, personnel, compensation, and procurement.
Scope of Governance

Board Governance

Organizational Governance

Plan Governance (Benefits and Investments)
Examples of Board Responsibilities – Plan Governance

- Appoint and evaluate consultants
- Oversee or approve benefit payments
- Hear appeals regarding disputes for issues within the board’s purview
- Set strategy and engage in monitoring and oversight of the system’s investments
- Set actuarial assumptions
- Approve contribution rates
- Ensure that systems are in place to monitor and routinely report on retirement system activities, processes, and risks
- Propose or recommend statutory amendments
- Develop policy to carry out an effective system of governance
- Promulgate rules to assist in the prudent administration of the plans
- Make and monitor delegations with respect to administration and investments
Examples of Board Responsibilities – Organizational Governance

• Appoint, oversee, and conduct a routine evaluation of the Executive Director and other top executive positions
• Appoint and evaluate consultants
• Develop and approve a strategic plan to guide the organization’s long-term direction
• Approve a budget
• Approve a compensation structure for the Executive Director and staff
• Ensure that systems are in place to monitor and routinely report on organizational activities, processes, and risks
• Oversee management’s framework of internal controls
• Engage in succession planning for the Executive Director and other executive positions under the Board’s authority
• Ensure the Executive Director has a succession planning / leadership development framework in place with respect to staff
• Set a tone at the top for ethics and risk
• Propose or recommend statutory revisions to aid the organization in achieving its vision
• Develop policy to carry out an effective system of governance
Examples of Board Responsibilities – Board Governance

- Elect board leadership
- Define committee structure and how board work is accomplished
- Develop policy to carry out an effective system of governance
- Annually evaluate the board’s own performance to yield governance improvements
- Enhance continuity of the board during transition through practices such as new trustee orientation
- Engage in continuing education to enhance board skills and knowledge
- Propose or recommend statutory revisions to aid the organization in achieving its vision
The Evolving Role of Public Retirement System Boards
Quick Quiz

What do the below have in common?

• U.S. Savings and Loans Institutions in the 1980s and 1990s
• Enron
• WorldCom
• Lehman Brothers
• AIG
• BP
• Wells Fargo
• Uber
The Role of the Board Has Evolved and Continues to Evolve

• Evolution of boards extends beyond corporate boardrooms.

• Public retirement system boards have taken an increased interest in:
  – Strategy
  – Compliance
  – Succession planning / leadership development
  – Oversight of technology, including cybersecurity and systems modernization projects
  – Enterprise risk management
  – Organizational culture
  – Stakeholder relations and branding

• Common Challenges:
  – Finding time on the Board agenda
  – Drawing clear boundaries between the Board’s role and that of management

Public Retirement System Committees

• Standing committees are based on the scope of a board’s oversight authority, governance model, and role

• Research on a select group of 10 TMRS peers¹ with oversight over both pension administration and investments revealed the following:
  − Average Board Size – 9.1 (ranged from 8 to 17)
  − Average Number of Standing Committees – 3.6 (ranged from 0 to 8)
  − Most Common Standing Committees (total = 18 different types of distinct committees)
    • Audit (6 peers)
    • Investment (6 peers)
    • Legislative (3 peers)
    • Defined Contribution/Deferred Compensation (3 peers)
    • Governance, Benefits, Personnel/Compensation, Budget Committees (2 peers)
    • Advisory Committees (2 peers)

¹. Peers were selected to reflect a mixture of similar asset size/scope, geography, and audience served and include the following systems: Illinois Municipal Retirement Fund, Texas Employees Retirement Fund, Mississippi Public Employees Retirement System, Texas County and District Retirement System, City and County of San Francisco, Los Angeles Fire and Policy Pension Fund, Teachers’ Retirement System of Louisiana, Kansas Public Employees Retirement System, and Missouri Local Government Retirement System
Public Retirement System Committees (Cont’d)

• Common practice is for committees to be non-delegated committees
  − They may make recommendations but do not make final decisions.
  − They assist the board in doing research or vetting of a matter before it is presented to the full board.

• Some public retirement systems have extended the Advisory Committee approach (whereby non-board members sit along side board members) to non-benefits related topics, including investment and audit committee.

• Over the past decade, there has been a trend toward investment committees of the whole

• Some systems that have no standing committees may use ad hoc committees for special purposes
TMRS Committee Structure

• The TMRS Board relies on the following standing committees to conduct its business:
  − Audit Committee
  − Compensation Committee
  − Legislative Committee
  − Budget Committee
  − Advisory Committee on Benefit Design

• Charters for all Committees exist or are in the process of Board review and approval.

• Committees, other than the Advisory Committee, are comprised of two members of the Board.

• Each Committee is supported by the Executive Director and appropriate staff.

• All of the committees are non-delegated committees.
A Closer Look – TMRS Advisory Committee and Legislative Committee

• The Advisory Committee on Benefits Design is comprised of two Board members and 10 Individual and Group Class Representatives (non-Board members) appointed by the Board.

• The Advisory Committee and Legislative Committee both assist the Board with Legislative matters.
  − The Advisory Committee studies topics assigned to it by the Board and provides its assessment of the advantages and disadvantages of each topic to the Board.
  − Should the Board choose to initiate legislation, the Legislative Committee works closely with staff to draft the TMRS legislation.
  − The Legislative Committee also is available to assist staff with Legislative related activities such as outreach.
Discussion - Committees

- What is the Board’s reaction to the peer research?
- Does the Board believe that it has the right balance of committees to conduct its business?
- Are there areas where further clarification is needed, and if so, where?
- Are there areas where the Board may benefit from additional Committees?
- What additional research or other enhancements ought to be considered?
Oversight of Public Retirement Systems

The Role of the Texas Pension Review Board
Oversight of Public Retirement Systems

• The manner in which states effect oversight of public retirement systems varies
  − Committee of the House, Senate, or a Joint Committee
  − Separate statutory entity

• The Texas Pension Review Board was established through the Texas Legislature to serve as the oversight body for all public retirement systems in Texas, including all statewide systems.
  − Other states with similar oversight organizations include Ohio, Kentucky, Oklahoma, Pennsylvania, Massachusetts and Colorado.
  − The PRB is a seven member Board

• Members of the Texas PRB are appointed by the Governor, with the advice and consent of the Senate
Texas PRB Purpose

• Provide Texas public retirement systems with information and recommendations to ensure that systems are:
  – Financially sound
  – Benefits are equitable
  – Properly managed
  – Tax expenditures are kept to a minimum

• Expand the knowledge and education of administrators, trustees, and embers of Texas public pension funds.
Texas PRB Purpose

• TMRS is required by law to file the following reports to the PRB:
  • Summary Plan Descriptions
  • Membership Report
  • Annual Financial Report
  • Investment Policy
  • Actuarial Valuation
  • Audits by governmental entities
  • Investment returns and assumption reports
  • Actuarial experience study
  • Funding soundness restoration plan

• The PRB also prescribes Minimum Educational Training requirements for all trustees.

• TMRS Staff tracks the requirements for its Board members.
TMRS Internal and External Experts

Overview of Roles and Responsibilities
Relationships Supporting the Board

- Board
  - Executive Director
  - Professional Advisors
    - General Counsel
    - Director of Internal Audit
    - TMRS Staff
  - Non-Investment
  - Investment
Delegation of Responsibilities

• The Board sets the policy and has delegated policy implementation and day-to-day management to the Executive Director.

• The Board oversees the implementation of its policies through periodic reporting provided by the Executive Director and Staff.

• Delegation by the Board occurs through:
  • Board decisions at meetings
  • Board policies
  • Board resolutions

• Consistent with best practice, the Board annually conducts an evaluation of the following:
  • Executive Director
  • Director of Internal Audit
  • General Counsel
### Professional Advisors – Overview

#### Non-Investment Advisors

<table>
<thead>
<tr>
<th>Provider</th>
<th>Responsibilities Overview</th>
<th>Current Provider(s)</th>
</tr>
</thead>
</table>
| Fiduciary Counsel     | Legal counsel to the Board on fiduciary matters  
|                       | Provides advice regarding regulatory matters                                                                                                                                                                             | Klausner, Kaufman, Jensen & Levinson      |
| Medical Board         | Evaluates and makes a recommendation to the Board as to whether a member is disabled.                                                                                                                                    | Dr. Ace Alsup  
|                       | Dr. William Deaton  
|                       | Dr. William Taylor  
| Independent Auditor   | Provides the Board an opinion on whether TMRS financial statements are presented fairly in accordance with the financial reporting framework.                                                                                | KMPG, LLP                                 |
| Actuary               | • Helps the Board establish funding methods and assumptions  
|                       | • Conducts an experience study  
|                       | • Recommends contribution rates for normal service and prior service costs.  
|                       | • Conducts an annual valuation of each participating municipality’s liability  
|                       | • Assists in special projects upon request.                                                                                                                                                                              | Gabriel, Roeder, Smith & Company (GRS)    |
| Legislative Consultant| Advises the Board on matters of importance to the Legislature and their potential impact to TMRS, including pending legislation.                                                                                          | Ron Lewis & Associates                    |
| Governance Consultant | Advises the Board on governance matters related to strategic planning, policy development, trustee education, and executive performance evaluations.                                                                           | Mosaic Governance Advisors, LLC           |
**Professional Advisors – Overview (Cont’d)**

**Investment Advisors**

<table>
<thead>
<tr>
<th>Service Provider</th>
<th>Responsibilities Overview</th>
<th>Current Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Investment Consultant</td>
<td>Provides advice to the Board on traditional asset classes, including the development of investment goals and objectives, investment policies and strategies, asset allocation decisions, high-level implementation issues, certain manager searches and terminations, benchmarks, and analysis of investment performance.</td>
<td>RVK</td>
</tr>
<tr>
<td>Private Equity Consultant</td>
<td>Provides advice to the Board on specific private equity related asset allocation strategies, asset class policies and procedures, recommends pacing strategy, manager selection and terminations, participates in ongoing manager monitoring/due diligence, recommends benchmarks, and analyzes investment performance.</td>
<td>StepStone Group, LP</td>
</tr>
<tr>
<td>Real Estate Consultant</td>
<td>Provides advice to the Board on specific real estate related asset allocation strategies, asset class policies and procedures, manager selection and terminations, participates in ongoing manager monitoring/due diligence, recommends benchmarks, and analyzes investment performance.</td>
<td>Courtland, a StepStone Group, LP company</td>
</tr>
<tr>
<td>Absolute and Real Return Consultant</td>
<td>Provides advice to the Board on specific absolute and real return related asset allocation strategies, asset class policies and procedures, manager selection and terminations, participates in ongoing manager monitoring/due diligence, recommends benchmarks, and analyzes investment performance.</td>
<td>Albourne</td>
</tr>
</tbody>
</table>
## Professional Advisors – Overview (Cont’d)
### Investment Advisors

<table>
<thead>
<tr>
<th>Service Provider</th>
<th>Responsibilities Overview</th>
<th>Current Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Managers</td>
<td>Implement various investment strategies in accordance with the Board’s investment policy statement.</td>
<td>As of 12/31/17, 100 different managers across various investment strategies</td>
</tr>
<tr>
<td>Depository Bank</td>
<td>Responsible for safekeeping certain of TMRS assets.</td>
<td>JPMorgan Chase Bank</td>
</tr>
<tr>
<td>Custodian Bank</td>
<td>Serves as the master custodian of TMRS’ assets and is responsible for maintaining the official book of record under the supervision of TMRS’ Investment Department Staff, calculating investment performance, and serving as an additional layer of risk control in the safekeeping of System assets. Conducts investment transactions under the instruction of TMRS.</td>
<td>State Street Bank and Trust Company</td>
</tr>
<tr>
<td>Economic Advisor</td>
<td>Periodically updates the Board on key events related to the health of domestic and international economies, highlighting areas of possible impact to TMRS as an institutional investor.</td>
<td>A. Gary Shilling &amp; Co.</td>
</tr>
</tbody>
</table>
Best Practices and Trends in Consultant Relationships

• Similar to the role of the Board, the roles and responsibilities of public fund board consultants is evolving.

• There is a greater need for consultants of different specialties to work together for the benefit of the board/system.

• More large public retirement system boards are:
  - seeking greater clarity in understanding the working relationship among the board, the consultants, and staff.
  - engaging in routine / periodic consultant evaluations to identify ways to optimize the working relationship.

• The manner in which the TMRS Board works with its consultants is consistent with common practice.

• Creating and implementing a process for the Board to review the role of its current consultants is an objective on the Board’s Strategic Plan.
Discussion – Consultant Relationships

• What information would help to further clarify the relationship between the Board and its consultants?

• What expectations or preferences for interaction does the Board have with respect to its consultants and how and when do those get conveyed?

• What ideas do the consultants have to share with the Board on the matter, and how should those be conveyed?

• How should staff’s evaluation of consultants be incorporated with the Boards?

• Other comments or desired areas of focus as staff works to develop the consultant evaluation process?
Board Meeting Effectiveness and Efficiency
Board Meeting Schedule

• By law, the Board must meet in March, June, September and December of each year, and for special meetings when called by the Executive Director.

• Historically the Board has met more frequently (8 times per year)

• The Executive Director and Chair have joint responsibility to develop and distribute each meeting’s agenda.

• The Board can only take official action at its meetings; all meetings must be open to the public.

• The Board can and does meet in Executive Session to discuss items that are exempted under open meetings laws.

• The Board traditionally holds a joint meeting with its Advisory Committee on Benefits Design in May.
Discussion – Best Practices in Meeting Effectiveness and Efficiency

• When viewed annually, are the Board’s agendas well balanced given its oversight role?
  – Do they allow time to focus on the most critical issues?
  – Are both forward-looking and retrospective topics covered?

• How could Board meeting time be used more effectively and efficiently?

• In what ways could information that the Board receives be enhanced?

• What areas or enhancements would the Board like to consider?
Wrap Up and Open Discussion
Recap: Specific PRB Objectives for Governance Education

- Be familiar with the composition of the TMRS Board and how Trustees are appointed
- Understand Board member responsibilities
- Understand the roles of the Board’s Committees, Executive Director and Staff
- Understand the roles and responsibilities of investment consultants and managers, the Board’s actuary, legal counsel, and auditors
- Know the ways in which management of the System is delegated to the Executive Director
- Comprehend the Board’s oversight role relating to contracted professionals
- Be familiar with the laws and rules governing public pension plans in Texas and any governing documents including bylaws
- Have a basic understanding of TMRS’ policies and procedures
- Understand best practices associated with good pension plan governance.
Feedback

• What went well?
• What enhancements would the Board suggest to make sessions like this a more productive and meaningful use of your time?
• Any other comments?

Thank you for your participation!
THANK YOU FOR YOUR TIME!

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