

Texas Municipal Retirement System

Discussion Continuation: Governance Models for Retaining, Managing and Terminating Investment Managers

September 26, 2019

*Presented in Connection with TMRS Strategic Plan
Goal 1 Objective B and Goal 3*

A Word About this PowerPoint Presentation

- This is a shorthand tool to assist the delegation narrative
- It is not a comprehensive policy document - it is a discussion starter
- The goal is to encourage your questions
 - ✓ and to get all your questions answered

Terms of Art

- This presentation uses investment terms of art
- If they require definition, it will be provided in the IPS
- The annual cycle for the IPS to be reviewed starts in October, with approval in December
- Today, if a term does not have context for you – Please Ask!

Some Reminders for Today

- The Executive Director will receive certain delegated responsibilities from the Board
- The Board will “confirm” or “receive and file” documentation that demonstrates that its policies have been followed via ED communication, and staff and consultants reports

Summary of August Meeting Discussion



Summary of August Meeting Discussion

- Discussed current pillars in place, legal standards of care, and alternative models
- Board Direction - Further discuss two models
 - Model A - Hybrid between Option 2 (Consent Agenda Confirmation) and Option 4 (Asset Class Percentage Limits)
 - Model B - Option 4 (Asset Class Percentage Limits)
- Today's Focus
 - Describe the Models in more detail
 - Flag potential sections of IPS changes
 - Discuss reporting package changes
 - Discuss the changes to the role of Board consultants
 - Seek Board direction on how to proceed
- Next Steps
 - Align direction with investment beliefs
 - Fully build out IPS and other governance documentation

Linking the Discussion to Investment Beliefs

Investment beliefs set the direction for the Board's investment policy, investment practice, organizational structure and culture

A coherent set of investment beliefs provide the basis for a good investment program. By agreeing upon and codifying investment beliefs, TMRS will be able to set a foundation for its decision making as well as encourage cultural alignment

- The Board, Executive Director and investment staff are key to translating investment beliefs into investment practice. It is critical that these stakeholders are closely involved in the process of developing the investment beliefs.

The Board owns the Investment Beliefs

As part of Investment Beliefs Survey, Board members had a high degree of similarity in views regarding manager selection/terminations/updates as it related to the use of Board time

Context for the Models

The Board has taken a comprehensive approach to evaluating its options and their implications with the help of its independent investment and governance consultants, and fiduciary counsel

The Board's initial decision to explore possible models was based on

- The Board's extensive history of being involved in this process and considering/approving over 50+ manager-related changes (e.g., approvals, re-ups, terminations, etc.)
- A desire to re-evaluate how Board time was being used and better align it with policy-level decisions

Context for the Models

Both Models Being Presented Today

- Offer **different degrees of delegated authority** to the Executive Director for the day-to-day implementation of the investment program
 - The final decision on the exercise of delegated authority under either model presented rests solely with the Executive Director, including a decision to reject a recommendation from investment staff and consultants
 - The Executive Director would not propose an alternative but would be able to say “no” and send the matter back for further study
- Designed on a **Variance or Exception** concept so that Board meeting time regarding these matters is focused on
 - Considering atypical investment transactions (and substituting an equally prudent process for routine transactions to flow through)
 - Reviewing performance against pre-established benchmarks with the help of the Board’s independent investment consultants
- Neither of the models completely extinguishes the Board’s approval authority over these matters
- Neither model would be implemented until January 1, 2020

Model A: Hybrid



Module A: Hybrid

How It Would Work

Public Markets Transactions

- The Board would authorize the Executive Director (ED), based on the Investment Committee's recommendation (including Investment Consultant), to enter into TMRS investment transactions below certain asset class percentage thresholds for **public markets** investment transactions

Public Markets

- Actively Managed Mandates: Up to 1.50% of the market value of the System's assets
 - Factor-based Mandates: Up to 3.00% of the market value of the System's assets
 - Passive Mandates: At the discretion of staff consistent with the Board's investment beliefs
 - Reducing assets under management, including full termination of a mandate, may not exceed 5.0% of the market value of the System's assets. However, a mandate may be terminated with the agreement of the Executive Director and Chief Investment Officer at any percent of assets if the removal is deemed necessary to protect the System's assets
- Those investment transactions would be reported to the Board as an information item at the next Board meeting
 - All public markets investment transactions above the asset class percentage thresholds must be brought to the Board for presentation and approval prior to entering into the transaction

Module A: Hybrid (cont'd)

How It Would Work

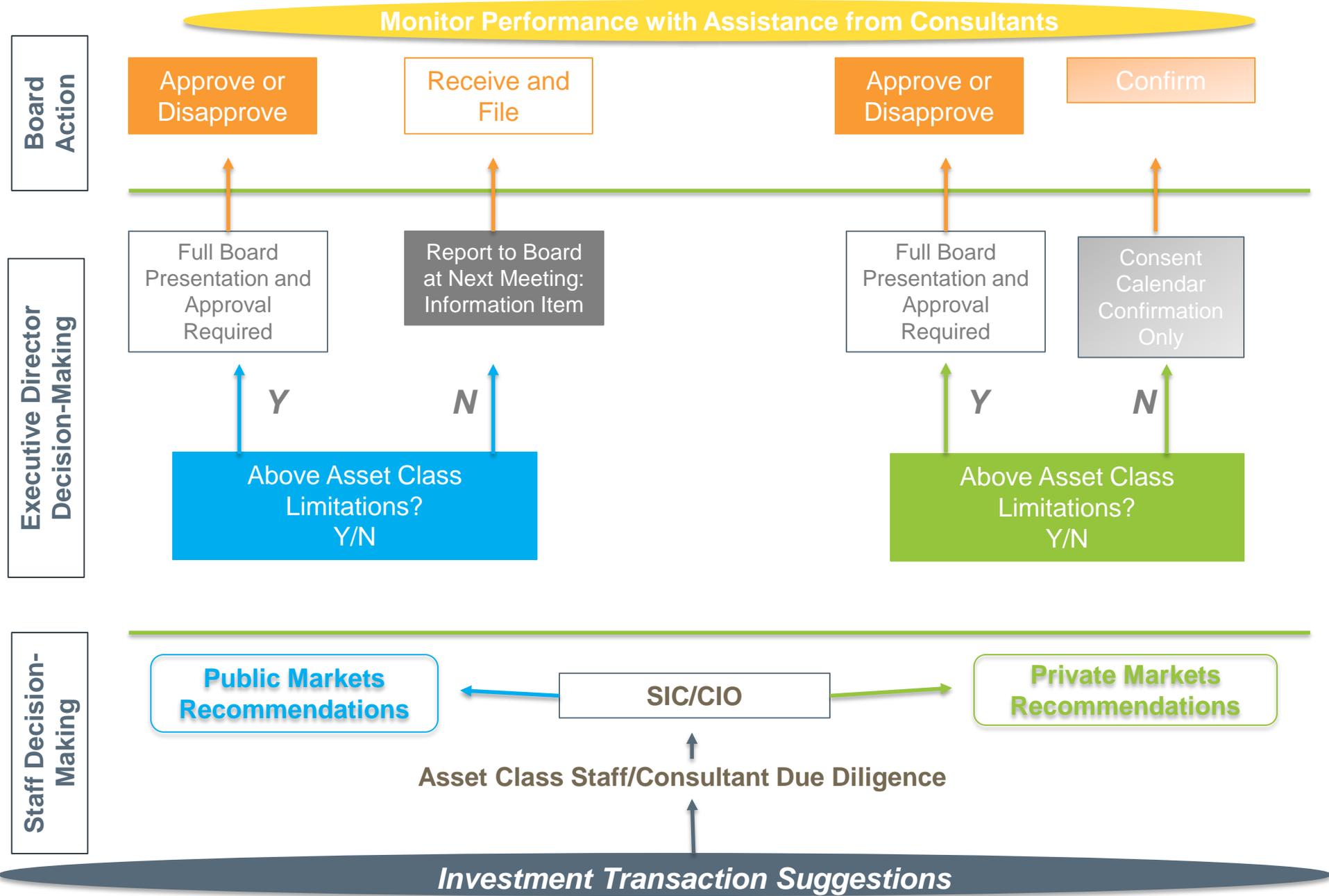
Private Markets Transactions

- The Board would authorize the ED, based on the Investment Committee's recommendation, to enter into TMRS investment transactions below certain asset class percentage thresholds for **private markets** investment transactions

Private Markets

- Up to 0.75% of the market value of the System's assets
 - Reducing assets under management, including full termination of a mandate, may not exceed 5.0% of the market value of the System's assets. However, a mandate may be terminated with the agreement of the Executive Director and Chief Investment Officer at any percent of assets if the removal is deemed necessary to protect the System's assets
- The ED would recommend confirmation of those **private markets** investment transactions already entered into by TMRS and include verification of due diligence process through the ED's Board Communication Memorandum
 - The Consent Agenda is adopted as one item
 - All **private markets** investment transactions above the asset class percentage thresholds must be brought to the Board for presentation and approval prior to entering into the transaction

How it Looks: Model A: Hybrid



Changes Needed to the IPS to Accommodate Model A

Please see the handout which includes sample changes to pages 6 through 10 of the Investment Policy Statement to illustrate potential changes that would need to be made. The formal IPS review process begins in October of this year.

Important sections where changes would need to be made

- Addition of Section VII – Delegation of Authority
- Revisions to Section VIII – Responsible Parties and Their Duties

Reporting Package for Model A

How It Would Work

The Board would receive the same materials as it does currently for **private market investments**, but they would be included with other Consent Agenda items

- ✓ Board Communication from the Executive Director
- ✓ Staff Memorandum Recommendation
- ✓ Consultant Memorandum Recommendation

Reporting to the Board by Staff and Consultants would not change

- ✓ Chief Investment Officer Management Updates
- ✓ Chief Investment Officers Quarterly Staff Report
- ✓ Consultant Quarterly Performance Review and Investment Policy Compliance
- ✓ Staff Annual Asset Class Reviews and Pacing
- ✓ Staff Annual Risk Report
- ✓ Staff Annual Compliance Report
- ✓ Internal Audit

New Recommended Addition to Board Processes or Reports

- ✓ Executive Director's report to include memorandum on recent investment transactions made under the delegation of authority
- ✓ Quarterly Staff Investment Committee Report
- ✓ Annual Closed Session Review with Consultants

Implementation

January 1, 2020

Model B: Asset Class Percentage Limits



Model B: Asset Class Percentage Limits

How It Would Work

Public Markets Transactions

- The Board would authorize the ED, based on the Investment Committee's recommendation (including the Investment Consultant), to enter into TMRS investment transactions below certain asset class percentage thresholds for **public market** investment transactions
 - Public Markets
 - Actively Managed Mandates: Up to 1.50% of the market value of the System's assets
 - Factor-based Mandates: Up to 3.00% of the market value of the System's assets
 - Passive Mandates: At the discretion of staff consistent with the Board's investment beliefs
 - Reducing assets under management, including full termination of a mandate, may not exceed 5.0% of the market value of the System's assets. However, a mandate may be terminated with the agreement of the Executive Director and Chief Investment Officer at any percent of assets if the removal is deemed necessary to protect the System's assets
- Those investment transactions would be reported to the Board as an information item at the next Board meeting.
- All **public market** investment transactions above the asset class percentage thresholds must be brought to the Board for presentation and approval prior to entering into the transaction.

Model B: Asset Class Percentage Limits (cont'd)

How It Would Work

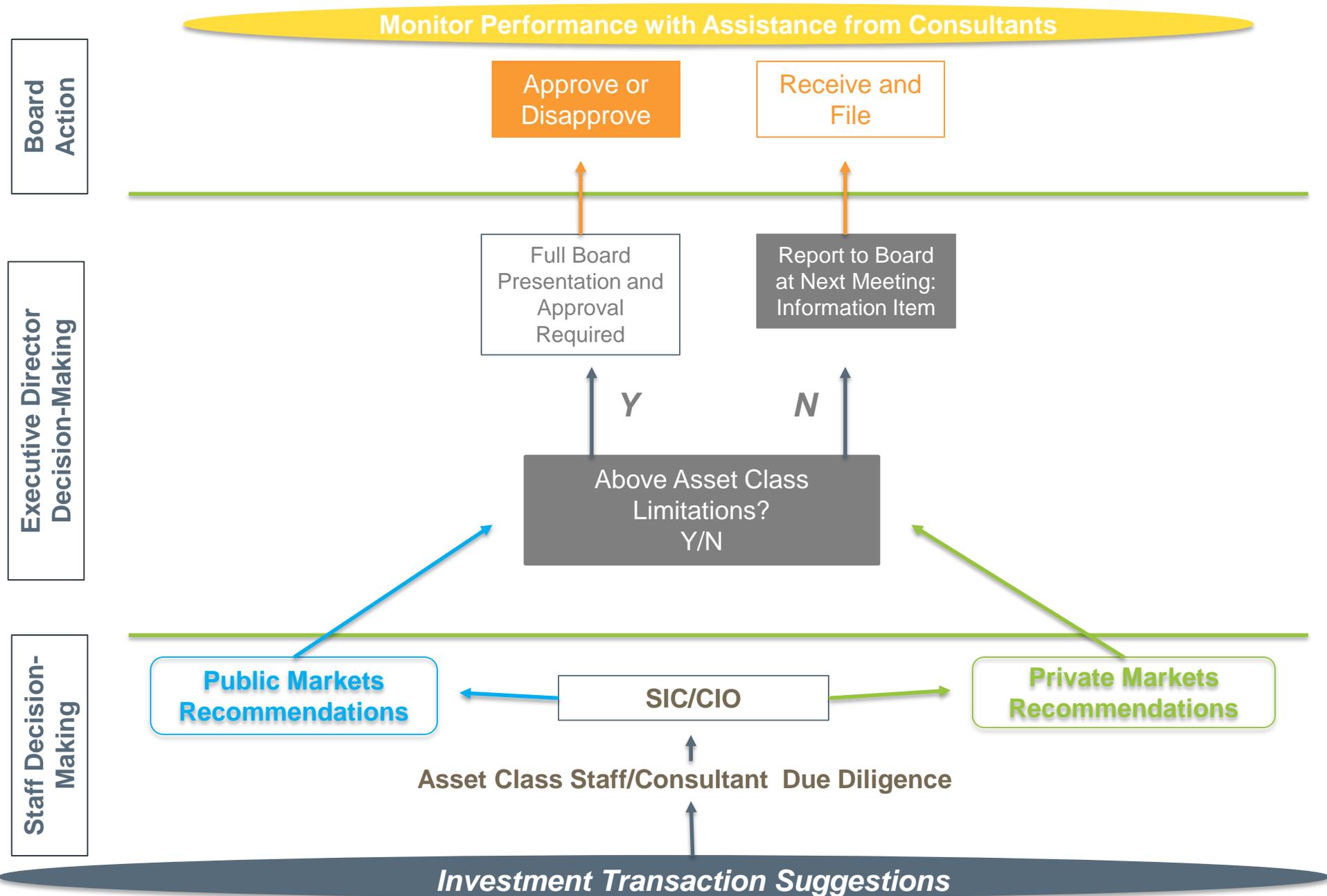
Private Markets Transactions

- The Board would authorize the ED, based on the Investment Committee's recommendation, to enter into TMRS investment transactions below certain asset class percentage thresholds for **private market** investment transactions

Private Markets

- Up to 0.75% of the market value of the System's assets
 - Reducing assets under management, including full termination of a mandate, may not exceed 5.0% of the market value of the System's assets. However, a mandate may be terminated with the agreement of the Executive Director and Chief Investment Officer at any percent of assets if the removal is deemed necessary to protect the System's assets
- Those investment transactions would be reported to the Board as an information item at the next Board meeting.
 - All **private markets** investment transactions above the asset class percentage thresholds must be brought to the Board for presentation and approval prior to entering into the transaction.

How it Looks: Model B: Asset Class Percentage Limits



Changes Needed to the IPS to Accommodate Model B

Please see the handout which includes sample changes to pages 6 through 10 of the Investment Policy Statement to illustrate potential changes that would need to be made. The formal IPS review process begins in October of this year.

Important sections where changes would need to be made

- Addition of Section VII – Delegation of Authority
- Revisions to Section VIII – Responsible Parties and Their Duties

Reporting Package for Model B

How It Would Work

Reporting to the Board by Staff and Consultants would not change

- ✓ Chief Investment Officer Management Updates
- ✓ Chief Investment Officers Quarterly Staff Report
- ✓ Consultant Quarterly Performance Review and Investment Policy Compliance
- ✓ Staff Annual Asset Class Reviews and Pacing
- ✓ Staff Annual Risk Report
- ✓ Staff Annual Compliance Report
- ✓ Internal Audit

New Recommended Addition to Board Processes or Reports

- ✓ Executive Director's report to include memorandum on recent investment transactions made under the delegation of authority
- ✓ Quarterly Investment Committee Report
- ✓ Annual Closed Session Review with Consultants

Implementation

January 1, 2020

Recap: Checks and Balances

Checks and Balances

Assurances – Delegate but Verify

- ✓ Investment Policy Statement (reviewed and updated annually)
- ✓ Qualified Professional Staff
 - Investments
 - Risk Management
 - Operations
 - Compliance
- ✓ Overlapping Independent External Consultants
- ✓ Appropriate Separation of Duties
 - Finance - \$\$ Movement
 - Reconciliation of Custodian to Financials
- ✓ Internal Legal Investment Expertise
- ✓ External Legal and External Fiduciary Counsel
- ✓ Internal Auditors
- ✓ External Auditors
- ✓ Reports to the Board
 - Quarterly Investment Report and IPS Compliance Review from the Board's Consultant
 - Annual Asset Class Reviews
 - Quarterly and Annual Risk Review
 - Quarterly and Annual Compliance Review
 - Quarterly Fee Report
 - Consultant Reviews

Checks and Balances

Assurances – Delegate but Verify

Internal Procedures Manual
TEXAS MUNICIPAL RETIREMENT SYSTEM

Internal Procedures Manual

Investment Department

JUNE 2019

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Internal Procedures Manual

Contents

- Investment Data Warehouse (IDW) Operating Procedures
- Alternative Investment Valuations for Interest Credit and CAFR
- Asset Allocation Study
- Background Checks
- Background Checks - Invoice Review
- Benchmark Selection Procedures
- Budget Proposal and Approval Process
- Business Continuity Plan (BCP)
- Co-Investment Underwriting Procedures
- Consultant Search, Selection and Oversight
- Contracting Procedures (Initial Investment)
- Credit Card Procedures
- Currency Repatriation and FX Spot Transaction Procedure
- Due Diligence
- eCFM Procedures
- Emergency Investment Manager Termination
- Employee Off-Boarding
- Employee On-Boarding
- Investment Committee and Board Agenda Item Preparation Procedures
- Investment Department Email Usage and Retention
- Investment Funding Sources
- Investment Manager Transitions
- IPS Review and Amendment (Annual and Ad Hoc)
- Investment Risk Management
- Israel Boycott
- Manager Onboarding: Contacts
- Manager Onboarding: FTP Set Up
- Manager Operations Exception Resolution
- Meeting Tracking and Reporting

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Internal Procedures Manual

- Monthly Close
- New Account Procedures
- Non-TMRS Technology Access
- Paying SMA Management Fees
- Powers of Attorney (POAs) for Proxy Voting
- Procedures: Ad Hoc Addition of New/Updated Procedures
- Procedures: Annual Review
- Proxy Voting
- Publicly Disclosed Material - Required Disclaimer
- Quarterly Staff Report
- Rebalancing
- Reimbursement for Attendance at Private Investment Fund/Industry Advisory Board Meetings or Due Diligence Travel
- Requests for Information (PIA Requests, Requests for Board Materials, Media Participation)
- Securities Litigation Procedures
- Taxation and Regulatory Reporting
- Trade Activity Falls
- Watch List Addition and Removal
- Website Updates
- APPENDIX
- Appendix A. Annual Certification of Compliance with Procedures
- Appendix B. Account Data Warehouse – Field Descriptions Table
- Appendix C. Portfolio Rebalancing Transaction Report
- Appendix D. Manager Search Staff Memo Template for Investment Committee Meeting
- Appendix E. Manager Search Recommendation Templates for Board Meeting
- Appendix F. Annual Asset Class Review Check Lists

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Checks and Balances

Internal Audit as the Third Line of Defense

Internal Audit as the Third Line of Defense



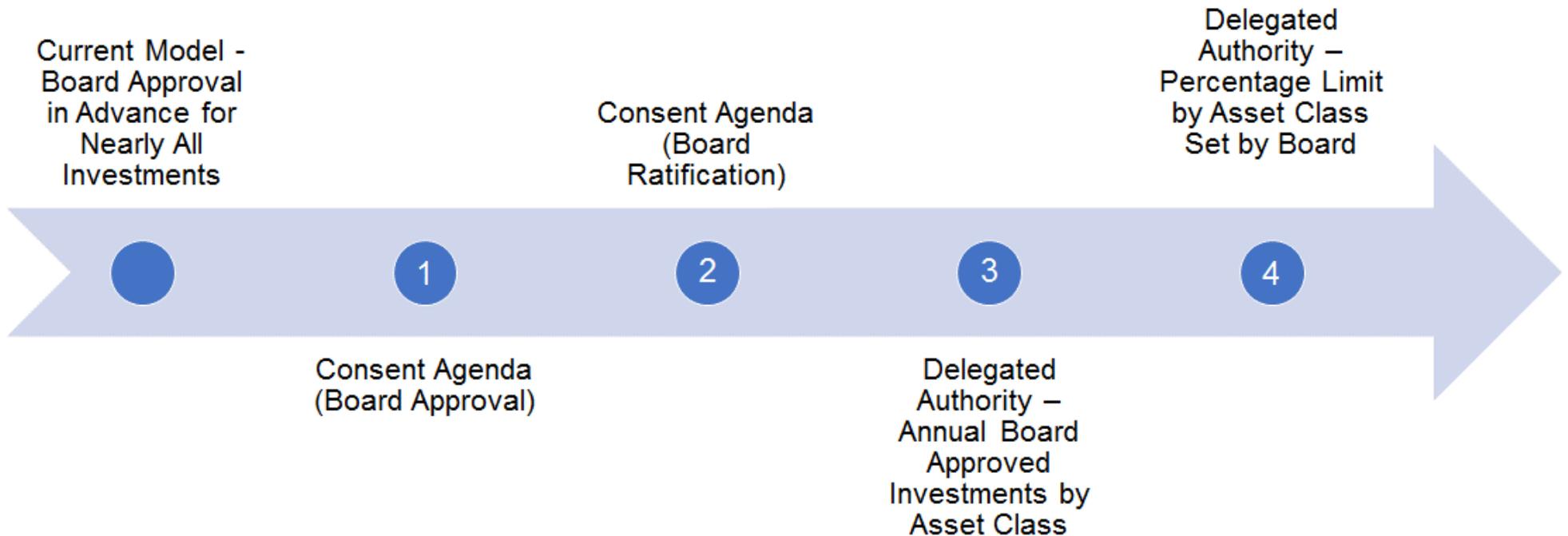
Board Direction

Board Direction

- What additional questions does the Board have about the two Models?
- How would the Board like to proceed?

Appendix: Recap of Models Reviewed at August Meeting

(listed in order from direct approval to delegated authority)



PORTLAND

CHICAGO

NEW YORK

