

# Recommendations for Investment Beliefs Statements Governance and Investment Policy

## Texas Municipal Retirement System

June 25, 2020

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

# Investment Beliefs – Project Goal and Approach

## Overall Goal for the Investment Beliefs Project

To arrive at Board consensus on 8 to 12 investment belief statements which encompass the following four categories: Investment Policy and Governance, Risk, Portfolio Construction, and Implementation.

Once the belief statements are finalized, they will be incorporated into the Investment Policy Statement.

This is reflective work that must be owned by the Board, but is contributed to by staff and consultants.

Refresher on our proposed approach to identifying belief statements

- Work through the four categories in sequence, identifying statements for each category as we go.
- Once the statements for a category are identified through consensus Board direction, we will set them aside until later this year.
- Later this year, during the Investment Policy Statement review, we will bring all the belief statements together for additional discussion and subsequent Board approval as part of the revised Investment Policy Statement process.

# Investment Beliefs - Today's Discussion

## Today's Discussion

Arrive at Board consensus on investment belief statements for the Investment Policy and Governance category on the following topics:

1. Mission, Vision, and Strategic Objective
2. Most Effective Use of Board Time
3. Governance
4. Investment Authority
5. Roles and Responsibilities

Most of these statements were previewed at the last meeting. Today we will see if there is Board consensus to move forward.

We will not be asking the Board to “vote”, only to provide consensus direction.

Questions?

# Recommendations Investment Beliefs Statements

## Category: Governance and Investment Policy

# Investment Policy and Governance Survey Statements

## Mission, Vision and Strategic Objective

**Survey Question 1: The Board's role is to focus on mission, vision and policy and to make sure that the governance structure and resources are in place to allow the System to meet its objectives.**

**Board Response:** 83% strongly agree, 17% agree  
*High Degree of Similarity*

**Staff Response:** 87.5% strongly agree, 12.5% agree

**Survey Question 2: The Board's mission, vision and strategic objectives for the System's investment program are appropriate and understood by Board members, TMRS staff and external service providers.**

**Board Response:** 67% agree, 33% unsure  
*Some Similar Views*

**Staff Response:** 12.5% strongly agree, 25% agree, 12.5% unsure, 37.5% disagree, 12.5% strongly disagree

# Investment Policy and Governance Investment Belief

## Mission, Vision and Strategic Objective



### Ties to the Board's existing Strategic Plan and Investment Policy Statement

|              |   |
|--------------|---|
| Mission:     | Providing secure, reliable retirement benefits              |
| Vision:      | To be the model for empowering retirement                   |
| Core Values: | Accountability, Excellence, Integrity, Respect and Teamwork |

### Recommended Investment Belief Statement

*Alignment of interests between the System, our members, beneficiaries and our advisors is critical to our success in meeting our strategic objectives.*

#### Requested Board Discussion for Today:

- What is the Board's reaction to this statement?
- What elements of the statement does the Board like?
- What concepts does the Board believe are missing?
- Are we at a point where we can proceed? If not, what are preferred next steps?

# Investment Policy and Governance Survey Statements

## Most Effective Use of Board Time

**Survey Question 3: What is the best and most effective use of Board members' time?**  
(1 - most important, 10 - least important)

**Board Response: #1 Setting and Monitoring long-term investment objectives, #2 Strategic Asset Allocation  
#9 Manager Selection/terminations/updates, #10 New Investment Opportunities**  
*High Degree of Similarity*

**Staff Response: #1 Setting and Monitoring long-term investment objectives, #2 Strategic Asset Allocation  
#9 New Investment Opportunities, #10 Manager Selection/terminations/updates**

**Survey Question 4: Delegating investment responsibilities to internal investment staff allows the Board to leverage governance resources and should be considered in order to improve efficiencies and the opportunities for successful investment outcomes.**

**Board Response: 17% strongly agree, 50% agree, 16% unsure, 17% strongly disagree**  
*Some Similar Views*

**Staff Response: 87.5% strongly agree, 12.5% agree**

# Investment Policy and Governance Investment Belief

## Most Effective Use of Board Time



## Recommended Investment Belief Statement

*The most effective use of the Board's expertise and time is to set overall investment objectives and clearly articulate investment direction through the System's Investment Policy Statement while continually monitoring its compliance.*

### Requested Board Discussion for Today:

- What is the Board's reaction to this statement?
- What elements of the statement does the Board like?
- What concepts does the Board believe are missing?
- Are we at a point where we can proceed? If not, what are preferred next steps?

# Investment Policy and Governance Survey Statements

## Governance

**Survey Question 5: Effective Governance, strong culture and talented staff are important drivers of a successful investment program.**

**Board Response:** 83% strongly agree, 17% unsure

*High Degree of Similarity*

**Staff Response:** 87.5% strongly agree, 12.5% agree

**Survey Question 11: Good governance is good business and contributes to the success of the investment program.**

**Board Response:** 83% strongly agree, 17% agree

*High Degree of Similarity*

**Staff Response:** 87.5% strongly agree, 12.5% strongly disagree

# Investment Policy and Governance Investment Belief

## Governance



## Recommended Investment Belief Statement

- Option A.** *Good governance contributes to the success of the System's investment program.*
- Option B.** *Good governance drives long-term value for the System and its membership.*

### Requested Board Discussion for Today:

- What is the Board's reaction to these statements?
- Does the Board prefer one Option over the other?
- What elements of the Option A does the Board like? Option B?
- What concepts does the Board believe are missing?
- Are we at a point where we can proceed? If not, what are preferred next steps?

# Investment Policy and Governance Survey Statements

## Investment Authority

**Survey Question 7: The Board has a clear understanding of the investment authority it has delegated to TMRS Executive staff.**

**Board Response: 67% agree, 33% unsure**

*Some Similar Views*

Staff Response: 25% agree, 12.5% unsure, 37.5% disagree, 25% strongly disagree

**Survey Question 8: The Board has a clear understanding of the investment authority it has delegated to TMRS investment staff.**

**Board Response: 50% agree, 50% unsure**

*Limited Similarity of Views*

Staff Response: 25% agree, 25% unsure, 37.5% disagree, 12.5% strongly disagree

**Survey Question 10: The span of control in place is appropriate for the Board, internal investment committee, staff & consultants.**

**Board Response: 67% agree, 33% disagree**

*Some Similar Views*

Staff Response: 12.5% agree, 12.5% unsure, 75% strongly disagree

# Investment Policy and Governance Investment Belief

## Investment Authority



## Recommended Investment Belief Statement

*The best investment results come from the right people making the right decisions and being held accountable for their performance.*

### Requested Board Discussion for Today:

- What is the Board's reaction to this statement?
- What elements of the statement does the Board like?
- What concepts does the Board believe are missing?
- Are we at a point where we can proceed? If not, what are preferred next steps?

# Investment Policy and Governance Survey Statements

## Roles and Responsibilities

**Survey Question 6: The roles and responsibilities of the Board, TMRS staff, consultants and other external providers are clear to all stakeholders.**

**Board Response: 33% agree, 67% unsure**  
*Limited Similarity of Views*

Staff Response: 12.5% agree, 12.5% unsure, 37.5% disagree, 37.5% strongly disagree

**Survey Question 9: Delegation of investment duties is clearly documented.**

**Board Response: 17% strongly agree, 16% agree, 67% unsure**  
*Limited Similarity of Views*

Staff Response: 12.5% agree, 12.5% unsure, 75% strongly disagree

# Investment Policy and Governance Investment Belief

## Roles and Responsibilities



## Recommended Investment Belief Statement

*Clearly defined roles and responsibilities are essential to good governance.*

### Requested Board Discussion for Today:

- What is the Board's reaction to this statement?
- What elements of the statement does the Board like?
- What concepts does the Board believe are missing?
- Are we at a point where we can proceed? If not, what are preferred next steps?

# Investment Beliefs Statements – Next Steps

## Category: Governance and Investment Policy

### Sustainability

# Investment Policy and Governance Survey Statements

## Sustainability - Environmental, Social and Governance (ESG) Factors

**Survey Question 12: Environmental, social and governance factors can impact investment performance and should be considered as important in TMRS' investment strategy.**

**Board Response: 17% strongly agree, 50% agree, 33% disagree**

***Limited Similarity of Views***

Staff Response: 50% agree, 25% unsure, 12.5% disagree, 12.5% strongly disagree

**Survey Question 13: Integrating corporate governance and corporate responsibility in TMRS' core investment process is important and adds value.**

**Board Response: 33% strongly agree, 33% agree, 34% unsure**

***Some Similar Views***

Staff Response: 25% strongly agree, 25% agree, 25% unsure, 25% disagree

# Investment Policy and Governance – Next Step

## Sustainability - Environmental, Social and Governance (ESG) Factors

To prepare for the ESG discussion, the Board will receive information on the following related topics from investment staff and consultants:

What is ESG?

What are other public funds doing?

What are managers doing to meet the increased interest in ESG mandates?

How to measure the risk?

How to benchmark performance?

What is TMRS currently doing with respect to ESG?

*Separate, but also related to Investment Policy and Governance is to explore the Board's views on proxy voting.*

# Appendix

## Sample Investment Belief Statements

# Sample Investment Beliefs

| Sample 1                          | Sample 2  | Sample 3   | Sample 4                                   | Sample 5  | Sample 6  | Sample 7  | Sample 8   |
|-----------------------------------|---|--|--|---|---|---|--|
| Invest for the long term.         | We are a long-term investor whose primary mission is to maintain the viability of the retirement system.  | Diversification strengthens the fund.  | Asset class decisions are key              | Liabilities must influence the asset structure.   | We value effective governance, leadership and strong culture as essential for a world-class investor. | Portfolio construction should focus first on the allocation and balancing of risk; it is the allocation of risk that drives portfolio returns.  | Our people drive our success.  |
| Invest in people.                 | Our strategic allocation policy is the primary determinant of the asset portfolio's long-term return and asset portfolio's risk.  | The global public investment markets are largely, but not completely, efficient. | Theories and concepts must be sound.       | A long time investment horizon is a responsibility and an advantage.  | We work to clear investment goals and accountabilities to meet our liabilities.                       | Diversification is critical because the future is unknown. Reliable diversification requires a fundamental understanding of the economic drivers of risk and return.  | The best investment results come from people who are empowered to make decisions and are accountable for them. |
| Build a high performance culture. | While we can sacrifice some short-term liquidity to pursue a greater long-term return, the investment portfolio's net cash flows and ability to pay benefits on a year-by-year basis are key risk considerations. | Managing investment costs yields long-term benefits.                             | House capital market views are imperative. | System investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries. | We act as a long-term investor.   | Every investment should be examined in the context of its potential return from beta (market return) to alpha (value added return); while separation is not always possible, every effort should be made to distinguish the two distinct return components. | Our brand is a strong and valuable asset.  |

# Sample Investment Beliefs

| Sample 1                  | Sample 2  | Sample 3  | Sample 4   | Sample 5   | Sample 6  | Sample 7  | Sample 8   |
|---------------------------|---|---|--|--|---|---|--|
| We are all risk managers. | Diversification improves the risk-adjusted return profile of the investment portfolio.                                | Internal management is critical.  | Investment strategies must be forward looking.   | Long-term value creation requires effective management of three forms of capital: financial, physical and human.             | Price matters so we will be patient but ready to act.                         | Flexibility to opportunistically alter the portfolio away from risk-balanced when markets are driven to extremes as result of short-term economic cycles is an important portfolio management tool. | Taking risk is necessary to earn the returns required to meet our pension obligations.   |
| Allocate wisely.          | There are long-term benefits to managing investment costs.  | The system can potentially capture illiquidity risk premium.  | Public markets are generally informationally efficient.                                  | The system must articulate its investment goals and performance measures and ensure clear accountability of their execution. | We believe diversification usually reduces risk more than return.             |   | We engage in active management, with a global perspective, to earn higher returns because we believe markets can be inefficient. |
| Costs matter.             | The equity risk premium is significantly positive over a long-term investment horizon although it can vary over time. | Managing short-term drawdown risk can positively impact the system's ability to meet its long-term financial obligations. | Market frictions are highly relevant.  | Strategic asset allocation is the dominant determinant of portfolio risk and return.   | In managing risk we recognize it is multi-faceted and not fully quantifiable. |   | Our investment strategy considers our risk profile, our plan assets and our liabilities.   |
| Collaborate widely.       | We benefit significantly when roles and levels of authority are clearly defined and followed.                         | Responsible corporate governance, including the management of ESG factors can benefit investors.                          | Internal investment professionals are the foundation of a successful investment program. | Risk to the system is multi-faceted and not fully captured through measure such as volatility or tracking error.             | We believe that costs matter and can be managed.                              |   | The returns we can expect will not be constant over time.  |

# Sample Investment Beliefs

| Sample 1                               | Sample 2  | Sample 3   | Sample 4   | Sample 5   | Sample 6  | Sample 7 | Sample 8   |
|--|---|--|--|--|---|----------|--|
| Diversity with care. Act with clarity. | Private market investments have an illiquidity premium that we can capture.   | Alignment of financial interest between the system and its advisors is critical. | Trustee expertise should be utilized while ensuring separation between board oversight and staff management. | The system will take risk only where we have a strong belief we will be rewarded for it. | We manage environmental, social and governance issues as they can have an impact on the long-term performance of investments. |          | Total fund diversification, through effective portfolio construction, is fundamental to our success. |
| Sustainability impacts investing.      | Utilizing engagement initiatives to address environmental, social and governance-related issues can lead to positive portfolio and governance outcomes.   |  |  | Costs matter and need to be effectively managed.   | We seek to achieve alignment of interests between ourselves, our beneficiaries and those acting on our behalf.                |          | Strong relationships support our success.  |
| Innovation counts.                     | It is extremely challenging for a large institutional investor to add significant value over market-representative benchmarks, particularly in highly-competitive public global equity markets. |  |  |  |   |          | Investing is a business.   |
|  |   |  |  |  |   |          | Good governance is good business and contributes to sustainable values.                              |

# Appendix

## TMRS' Hierarchy of Investment Decision Making

# Hierarchy of Investment Decision Making

