Evaluation of Investment Practices
Pursuant to Texas Government Code 802.109
Texas Municipal Retirement System
May 28, 2020
Evaluation of Investment Practices

• RVK was tasked with conducting an independent evaluation on the appropriateness, adequacy, and effectiveness of the Texas Municipal Retirement System investment practices and performance and to make recommendations for improving the TMRS investment policies, procedures, and practices. Per Texas Government Code 802.109, each evaluation must include five specific sections which are summarized on the following slides.

• RVK is uniquely qualified to perform this evaluation as we are one of the largest fully independent consulting firms in the world, with over 200 institutional clients and over $2 trillion of assets under advisement. We are strictly focused on providing our clients with non-discretionary consulting services and do not offer discretionary management of assets, nor do we offer any investment products. Since our founding in 1985, RVK has been an industry leader in adhering to a strict no-conflicts of interest policy, with 100% of our revenue generated from client fees; we do not accept fees of any kind from any investment manager or other service provider which our clients may ask us to evaluate.
Section 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

TMRS’ investment program is governed by the Investment Policy Statement (“IPS”) including the Investment Committee Charter and supported by the Internal Procedures, which together serve as the overarching program documents detailing the objectives and guidelines used for the management of System assets. The Board of Trustees (the “Board”) reviews the IPS at least annually, with the other documents maintained and managed by Executive and Senior Investment Staff. RVK finds all three documents to be clear, thoughtful, and comprehensive. The recent changes to the delegation model are also in line with what we consider to be best practices for management of System assets.

Recommendations for the Board’s Investment Policy Statement

- Finalize and update the Investment Beliefs and adopt a Fee Policy to assist investment decision-making.
- Where possible, simplification and concise statements would serve the Board in future IPS revisions.
Section 2: A detailed review of the retirement system's investment asset allocation, including:

(A) The process for determining target allocations;
(B) The expected risk and expected rate of return, categorized by asset class;
(C) The appropriateness of selection and valuation methodologies of alternative and illiquid assets; and
(D) Future cash flow and liquidity needs

The efforts from the Board and Investment Staff show a thoughtful approach to the selection of the Strategic Target Allocation, with particular emphasis on the 2019 Asset/Liability study. From this analysis, TMRS was able to narrow the potential range of outcomes, and create a set of target allocations applying reasonable judgement and its own investment beliefs throughout the process. The current TMRS target portfolio represents one that is diversified, with ample opportunity for growth without sacrificing material downside protection. The process to reach the current target allocation took place over multiple Board meetings and continues to be refined as appropriate with each new analysis performed.

Recommendation for the Board’s Asset Allocation

✓ Consider the inclusion of more differentiated portfolios in future asset/liability modeling.
Section 3: A review of the appropriateness of investment fees and commissions paid by the retirement system

The overall aggregate level of investment fees and commissions paid by TMRS is below market for its asset allocation, meaning its implementation has been successful in managing costs. With very few exceptions, fees paid to individual managers are among the lowest in the industry for each mandate and are a testament to the diligence and contracting processes currently in place. While there are several mandates within the portfolio where fees or commissions appear modestly above industry median, it is important to note that these are also areas in which TMRS is receiving a differentiated level of active performance in a manner consistent with the Board and Staff’s stance on use of active management. As such, higher fees in these areas may be warranted as overall net of fees performance remains attractive.
Section 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

Through a review of past and current policies, charters, and meeting materials, it is clear the TMRS investment decision making process and governance structure have been carefully constructed to reflect industry best practices. Notably, the separation of policy from procedures is an important and attractive characteristic of the TMRS investment program. Additionally, the ongoing education through formal training and meeting materials appear to satisfy certain requirements within Texas, while also providing Trustees with meaningful and important information critical to the management of System assets. Delegation of authority among Board, Executive and Investment Staff, and Investment Consultants are also clearly defined, with sound reasoning and a structure which allows for some degree of flexibility necessary to manage a successful investment program.
Section 5: A review of the retirement system's investment manager selection and monitoring process

The TMRS investment manager selection and monitoring process is well-defined and thoughtful in its approach. The TMRS Investment Staff diligently follows the policies and procedures as described and has made notable efforts in the improvement of their own due diligence efforts. The unique and differentiated approach to manager selection in both public and private markets, provides tangible and intangible benefits that a more common process followed by many peers may not afford, such as the demonstrated ability to negotiate lower fees and the avoidance of performance chasing behavior. While there are always areas to consider improvement, we believe the current process and documentation thereof is best-in-class within the public pension universe and commend the TMRS Board and Investment Staff on their efforts in the creation of a successful manager selection and monitoring program.

Recommendation for Manager Selection and Monitoring

✓ Consider the addition of mandatory Board reporting expectations for consultants and asset class directors as an addition to the IPS.
Questions?

What additional questions does the Board have about the Evaluation of Investment Practices?

Are there any issues in the Evaluation on which the Board would like more information?

The Evaluation of Investment Practices will be submitted to the Pension Review Board by June 1, 2020.