



September 14, 2021

To: Board of Trustees
From: Nick O'Keefe, Senior Investment Attorney 
Re: Agenda Item 9: Q2 2021 Investment Compliance Report

Effective June 14, 2021, TMRS' Investment Compliance Officer began reporting to the Chief Legal Officer instead of the Chief Investment Officer. Since then, I began overseeing the Investment department compliance activities.

One improvement we have made is to create a new, stand-alone investment Compliance Report for the Board. Previously, compliance reporting has been embedded within Investment staff's quarterly reports and annual asset class reviews. Attached is the Q2 2021 Investment Compliance Report, which I will discuss at the September Board meeting.

ATTACHMENT:

1 – Q2 2021 Investment Compliance Report



Q2 2021

Investment Compliance Report

Nick O'Keefe, Senior Investment Attorney

September 23, 2021

Board Investment Compliance Responsibilities

- **Board Investment Belief: IPS §V(B)**

“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.***” (emphasis added)

- **Board Responsibilities and Duties: IPS §VIII(A)(4)**

“Monitoring and evaluating the System’s investment performance and compliance with the provisions of this IPS and applicable state and federal laws.”

IPS Compliance Requirements

IPS §XIII: Compliance Program

- “Under the supervision of the Chief Legal Officer, compliance personnel shall design and implement a detailed compliance program which uses a combination of daily, weekly and monthly testing of all testable parameters of this IPS and all Manager guidelines at the Manager, asset class and total fund level as appropriate. Testing may be completed either through systematic resources (i.e., automated custodial compliance) or manually if necessary.”
- “Compliance personnel shall create and present a quarterly report to the Board with the results of the testing performed during each period.”

The TMRS Compliance Program

- TMRS staff has designed and implemented a Compliance Program to ensure compliance with TMRS' IPS, as well as TMRS internal investment procedures and Texas law.
- Under the supervision of TMRS' Chief Legal Officer, compliance personnel functions include, but are not limited to:
 - Ensuring TMRS Investment Staff and investment managers adhere to IPS Guidelines;
 - Confirming TMRS maintains compliance with any State prohibited investments (e.g., Israel boycott, Energy Company boycott).
 - Ensuring TMRS Investment Staff continually adheres to TMRS Personal Trading Policies;
 - Creating, with our Custodian, automated testing programs to ensure TMRS investment managers trade within approved investment guidelines; and
 - Periodically run manual tests to ensure integrity of all automated testing.

What is Investment Compliance Testing?

- The TMRS IPS §XIII states that compliance personnel shall design and implement a detailed compliance program testing all “***testable parameters***” of the IPS and all Manager guidelines.
- A Testable Parameter is an IPS requirement or Investment Manager investment guideline that can be determined either has been met or has not been met.
 - (Hint: the words “must”, “shall” and “will” typically create a “Testable Parameter”.)
- The IPS sets out 97 “testable parameters”, although not all testable parameters will apply to each asset class or investment strategy.

Examples of a “Testable Parameter”?

- Example: IPS §XX(B)(3)(c) describes Testable Parameters which only apply to Core Fixed Income.
 - §XX(B)(3)(c) Credit Default Risk...

The following are the minimum credit quality constraints:

 - i. All securities must be rated at least B- or equivalent
 - ii. The portfolio shall maintain a minimum weighted average credit quality of A+ or equivalent.
- Investment Guidelines for individual investment managers often include several more “testable parameters.” For example:
 - TMRS Trust Fund assets being managed by external Investment Managers.
 - TMRS often invests in Public fund investments using Separately Managed Accounts which include customized investment guidelines established by TMRS in the Investment Manager Agreement (IMA) with the Investment Manager.
 - On the other hand, Private fund investments generally do not contain customized investment guidelines established by TMRS.

Q2 2021 Testable Parameter Testing

- In Q2 2021, TMRS Investment Compliance personnel, together with State Street, TMRS' Custodian, completed 616 compliance tests, testing all applicable "Testable Parameters", on TMRS Investment Managers to ensure compliance with each Manager's applicable Investment Guidelines. These tests include:
 - 240 Investment compliance reports generated and reviewed to confirm TMRS investment activity is within IPS and Investment Manager specific investment guidelines.
 - 346 automated guideline Alerts (281) and Warnings (65) generated by State Street's automated testing required Compliance personnel to manually test certain items to confirm compliance.
 - Compliance personnel created 30 manual tests on separately managed accounts to confirm State Street's automated tests are capturing all testable parameters for investment guidelines.

Q2 2021 Testable Parameter Testing (cont.)

- In addition to 616 tests which test the investment guidelines that apply to individual investment managers, TMRS Compliance also completes a manual check to ensure TMRS compliance with the Investment Guidelines that apply to the System's overall investment portfolio and to each asset class.
- **Ongoing Team effort:** TMRS investment staff continuously monitors IPS compliance within each asset class as well as compliance for each of their private investment funds.

Q2 2021 Testing Results: Good News

- TMRS and its Investment Managers complied with all Testable Parameters.

