Texas Pension Review Board

INVESTMENT COMMITTEE MEETING

SEPTEMBER 29, 2020

TEXAS PENSION REVIEW BOARD

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TEXAS PENSION REVIEW BOARD
INVESTMENT COMMITTEE MEETING

AGENDA

Tuesday, September 29, 2020 – 10:00 AM

By Teleconference

Public Participation Dial-in Number: (877) 853-5247 (Toll-free)
Meeting ID: 860 3975 1608

The September 29, 2020 meeting of the Investment Committee of the PRB will be held by teleconference call as authorized under Sections 551.125 and 551.127 of the Texas Government Code. THIS MEETING WILL BE CONDUCTED BY TELECONFERENCE IN ACCORDANCE WITH THE GOVERNOR'S AUTHORIZATION OF MARCH 16, 2020, CONCERNING SUSPENSION OF CERTAIN OPEN MEETING LAW REQUIREMENTS IN RESPONSE TO THE DECLARATION OF STATE DISASTER OF MARCH 13, 2020 CONCERNING THE COVID-19 (CORONAVIRUS) PANDEMIC. A quorum of members of the committee will participate in the meeting and will be audible to the public. Members of the public may provide public comment by registering first with the Office Manager by submitting an email to Lindsay.Seymour@prb.texas.gov identifying the name of the speaker and topic, no later than 8:00 am on September 29, 2020. The presiding officer will call roll of committee members, followed by calling roll of members of the public who have registered. The presiding officer will then ask if other attendees wish to provide comment, at which time each such attendees shall identify themselves by name and topic of the comment. Members of the public who have registered during roll call will be called by name at the appropriate time in the agenda. Attendees are requested to mute their connections when not addressing the committee members.

Access to the agenda materials of the meeting is provided at www.prb.texas.gov. A recording of the meeting will be available at www.prb.texas.gov.

The Committee may discuss or take action regarding any of the items on this agenda.

1. Meeting called to order
2. Roll call of Committee members
3. Roll call of members of the public
4. July 28, 2020 Committee meeting minutes

5. Update on Investment Practices and Performance Evaluations as required by Government Code Section 802.109 (SB 322), including:
    a. Reporting compliance as required by SB 322
    b. Draft report on Investment Practices and Performance Evaluations
    c. Recommended improvements to Investment Practices and Performance Evaluation statute
    d. Updates on correspondence with certain systems regarding concerns with Investment Practices and Performance Evaluations
6. Date and location of next Investment Committee meeting – TBD
7. Invitation for public comment
8. Adjournment

NOTE: The Committee may go into closed session concerning any item on this agenda if authorized under the Texas Open Meetings Act, Government Code, Code Ch. 551. Persons with disabilities who plan to attend this meeting and who may need special assistance are requested to contact Mr. Wes Allen at (800) 213-9425/ (512) 463-1736 three to five (3-5) working days prior to the meeting date so that appropriate arrangements can be made.

1. Meeting called to order

2. Roll call of Committee members

3. Roll call of members of the public

4. July 28, 2020 Committee meeting minutes

TEXAS PENSION REVIEW BOARD

Investment Committee Meeting Minutes
July 28, 2020

1. **Meeting called to order (0:15)**

   The Pension Review Board (PRB) Investment Committee Meeting was called to order by Chair Christopher Zook on Tuesday, July 28, 2020, at 9:30 am via teleconference.

2. **Roll call of Committee members (0:48)**

   Committee members present:
   Chair Christopher Zook
   Keith Brainard
   Shari Shivers
   A quorum being present, the meeting was called to order by Chair Zook.

3. **Roll call of members of the public (1:05)**

   There were no pre-registered members of the public who would be providing comments.

4. **May 7, 2020 Joint Meeting of the Investment and Actuarial Committees minutes (2:10)**

   Chair Zook entertained a motion to suspend the reading of the minutes of the May 7, 2020 joint meeting of the Investment and Actuarial Committees and approve them as circulated.

   The motion was made by Mr. Brainard and seconded by Ms. Shivers.

   The motion passed unanimously.

5. **Investment Practices and Performance Reports received as required by Government Code Section 802.109 (SB 322) (3:06)**

   Robert Munter and Kenny Herbold presented information on the Investment Practices and Performance Evaluations (IPPEs) that were due to the PRB on June 1, 2020.

   Mr. Munter stated that staff expected to receive 55 evaluations and included 37 of the received evaluations for this presentation. The PRB had been in contact with the nine systems that had not yet submitted their required evaluation. He noted that most systems' acting investment consultants conducted the majority of evaluations and outside independent firms only conducted seven evaluations. Mr. Munter noted that more than half of the evaluations did not provide any recommendations for improvement; however, all independent third-party evaluators provided at least one.

   He noted that the main takeaways so far from the recommendations were that systems should review their investment policy statement (IPS) at least annually, review and consider their governance practices and procedures, review and consider investment fees, increase trustee training, improve transparency and ensure all processes were well-documented and defined in the IPS.

Mr. Brainard asked if the recommendations indicated some systems were not reviewing their IPS or peer performance at least annually. Mr. Munter stated that it varied, as several recommendations were to continue reviewing the IPS and to use requests for proposal (RFPs) as a tool to verify investment consultant fees are in line with industry standards and peers.

Ms. Shivers asked if staff used Texas Treasury, Permanent School Fund and the University of Texas/Texas A&M Investment Company as benchmark resources. Mr. Munter stated that staff only considered the resources identified by the evaluators but noted those additional resources could be considered in the future.

Mr. Munter noted that the main takeaway from the overall recommendations was that plans should routinely review their investment practices and procedures. He stated that the investment-related processes should be well documented and defined in the IPS. He noted that an additional takeaway from the overall recommendations was the need to clarify and document policies and practices. Mr. Brainard asked if some systems lacked an IPS, and if so, how many. Mr. Herbold clarified having an IPS was a statutory requirement for all systems.

Mr. Munter pointed out evaluators identified the standards, benchmarks, and resources for major components of the IPPEs. He stated that staff was working to make a compendium of those resources available to systems in the future.

Mr. Herbold stated that the evaluations contained extremely useful information that would improve understanding of board and consultant actions. He noted that staff planned to present a more thorough analysis of the IPPEs at the September 29th Investment Committee meeting. Mr. Herbold stated that it was his understanding that the intent of the law was to increase transparency and strengthen oversight of investment-related decisions. He noted that the IPPES contained a common recommendation for additional documentation or clarification of existing policies in the IPPEs.

Mr. Herbold noted the PRB identified five elements for the evaluations in the informal guidance issued to systems, which included: identifying and reviewing existing policies and procedures; comparing existing policies and procedures to best practices; assessing if policies were being followed; identifying strengths and weakness of policies; and providing a description of the methodology.

Mr. Herbold provided the Committee with sample evaluations from four consulting firms that included the five elements from the IPPE informal guidance and provided transparency about the systems' investment practices. He noted that more than half of the evaluations received by the PRB did not include any specific recommendations, which caused concern in some cases, but was understandable when the IPPE provided a thorough explanation about how the board was adhering to industry standards and did not recommend or require improvement.

Chair Zook clarified that IPPEs should evaluate and provide recommendations to systems, but he felt that it was acceptable to not include recommendations when evaluators offered a detailed explanation. Chair Zook also noted that since this was the first time , there may have been some disparity between systems regarding the intended purpose of the evaluations. It appeared that some systems may have considered the evaluation a means of confirming their current practices whereas others received recommendations and compared the system's practices to industry best practices. He stated the PRB could potentially help guide this process and develop a standard methodology. He asked staff to reach out to the systems that did not provide substantive IPPEs and show them examples of what the PRB was looking for to help them shape their reports. Mr. Herbold noted that staff already had some conversations with systems and their consultants and could continue to do so. He stated the systems the PRB had spoken with were willing to make improvements as needed.

Mr. Brainard noted that in addition to the requirement for systems to identify recommendations, the statute could be revised to specify that the system would demonstrate that their policies and procedures were effective in their IPPEs. Chair Zook stated that could potentially be included when preparing the report for the Legislature.

The Committee discussed the extent of a board's involvement in the evaluation process. Mr. Brainard stated he would like a retirement system's board to verify that they read and reviewed the evaluations; Chair Zook clarified the requirement for board verification should be codified in statute.

Mr. Brainard stated that another addition he would like considered in future reports was the identification of the percentage of portfolios that were actively managed versus passively managed.

Ms. Shivers stated that she supported the recommendation for having a system's board acknowledge they have reviewed the IPPE and that she supported informally reaching out to systems that did not provide recommendations or reasons for not having any recommendations.

Chair Zook asked the Committee to consider recommending the Legislature amend the statute to include in the IPPE the acknowledgment of any potential conflicts of interest, which would include the system's investment consultant completing the evaluation. He stated that for all systems who had their acting consultant conduct the IPPE, their boards should have been aware that those consultants may have been unlikely to state anything negative about themselves. He noted he was not surprised that the independent third-party IPPEs contained many recommendations, whereas reports completed by acting consultants had fewer. He recognized that it was expensive for some systems to hire a third-party consultant for the review, so it was important to have stakeholders of those systems hold their active consultants to an extremely high standard. He acknowledged that the use of independent consultants was a contested issue during the legislative session, and he commended the legislature for the requirement as it would strengthen the overall ability for systems to pay their members' benefits. Chair Zook noted that he would like staff to come to the next meeting with the top five priorities staff would recommend to the legislature to continue to strengthen the IPPE statute and to include suggestions by Committee members.

6. Date and location of next Investment Committee meeting – September 29, 2020 (1:08:26)

Chair Zook stated that the next Investment Committee meeting would be held on September 29, 2020.

7. Invitation for public comment (1:09:20)

There were no public comments.

8. Adjournment (1:10:14)

Chair Zook adjourned the meeting at 9:40 am.

PRB Staff in Attendance:

Anumeha Kumar
Michelle Downie Kranes
Ashley Rendon
Benjamin Warden
Bryan Burnham
James King
Kenny Herbold
Lindsay Seymour
Mariah Miller
Robert Munter
Wesley Allen

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Chair Christopher Zook

5. Update on Investment Practices and Performance Evaluations as required by Government Code Section 802.109 (SB 322), including:

5a. Reporting compliance as required by SB 322

Compliance

- Evaluations due June 1, 2020
- **55 evaluations**, covering **62 plans** expected
- 2 evaluations from systems with less than $30 million
- **5 evaluations** not yet submitted:
  - Corpus Christi RTA
  - Denton FRRF
  - Harris Co Hospital Dist
  - Midland FRRF
  - Naco Co Hospital Dist

5b. Draft report on Investment Practices and Performance Evaluations

5c. Recommended improvements to Investment Practices and Performance Evaluation statute

Draft Report on Investment Practices and Performance Evaluations

Investment Committee Meeting

September 29, 2020

Pension Review Board

PRB's Investment Performance Report

Section 802.109(i) "the board shall submit an investment performance report … [that] must compile and summarize information received under this section."

I. Executive Summary
II. Overview of Law and Compliance
III. PRB Analysis
IV. Recommendations
V. Evaluation Summaries
VI. Resources

Pension Review Board

PRB Analysis

Intended to provide a 30,000-foot view of the evaluations

- What did we learn about the investment practices of Texas systems?
- What were the most common recommended changes?
- What practices and/or resources were highlighted that can be useful to other systems?
- What recommendations can be made to improve future evaluations?

Potential Legislative Recommendations

- Legislative intent was to provide more transparency surrounding board activities with respect to investment governance and decision-making.
- Systems continue to seek clarity about what information should be included in an evaluation report.
- The evaluation report provides a unique opportunity for a comprehensive review, and communication, of investment decision-making practices.
- Legislative recommendations primarily focus on clarifying what should be included within the evaluation report for the benefit of all stakeholders.

Potential Legislative Recommendations

1) Clarify the report of the evaluation should include a description of how the analysis or review was performed including a clear explanation of how the evaluator determined the need, or lack there-of, for a recommendation for improvement.

- The purpose is to "evaluate the appropriateness, adequacy, and effectiveness of the retirement system's investment practices and performance and to make recommendations for improving the retirement system's investment policies, procedures, and practices."
- Existing law does not clearly articulate which aspects of the evaluation should be communicated and how.
- In general, evaluations included at least a high-level description of the existing "investment policies, procedures, and practices."
- When a recommendation was made, the evaluator justified the recommendation with an explanation where the existing approach fell short. However, when no recommendation was made, not all evaluators provided an explanation as to why existing practices are appropriate, adequate and/or effective.
- Including an explanation both when a recommendation is made, as well as when the evaluator deems no recommendation is necessary, would significantly enhance stakeholder understanding of the investment decision-making process and help foster "informed decision-making."

Potential Legislative Recommendations

2) Disclosures required by the evaluator should include:

- *Qualifications of the evaluator*
- *Nature of relationship between evaluator and plan and an acknowledgement of potential conflicts of interest as a result of an existing relationship*
- *Identification of remuneration received by the evaluator*
- *Acknowledgement the firm is not directly or indirectly managing investments*

- Current law does not specify any required disclosures by the evaluator.
- Some evaluations did not clearly identify who performed the evaluation nor if the evaluator had "substantial experience in evaluating institutional investment practices and performance," which made it difficult to determine if the evaluation complied with the law.
- Requiring the disclosures identified in the PRB's *Guidance for Investment Practices and Performance Evaluations* and adding a conflict-of-interest provision would improve transparency around who is performing the evaluation, as well as make it easier for stakeholders to evaluate the efficacy of the evaluation.

Potential Legislative Recommendations

3) Clarify a preliminary draft that is substantially complete shall be submitted to the governing body of the retirement system for discussion and clarification; and request a written response be submitted to the independent firm acknowledging receipt by the board, anticipated or completed actions regarding any recommendations made, and any additional comments the retirement system wants to be included as part of the final evaluation report.

- Recommendation modeled after actuarial audit requirements.
- Clearly identifies the report is a product of the independent firm.
- Clearly establishes the retirement system has considered the evaluation, as requested by the Investment Committee.
- Provides stakeholders with what actions the retirement system intends to take on any recommendations made.

Potential Legislative Recommendations

4) Clarify the independent firm conducting the evaluation may not be the same firm that helped the system develop the existing investment policies, procedures, and practices. The independent firm could be engaged for the purpose of this evaluation by the sponsoring governmental entity.

- Both the retirement system and the sponsoring governmental entity have a vested interest in ensuring the retirement system's investment governance and decision-making are performed utilizing industry best practices.
- Investment Committee members noted, and the data appear to suggest, existing consultants may be less likely to identify areas for improvement if they were directly involved in the development of the existing practice.
- Similar investment evaluation legislation in Texas prior to SB 322 did not permit existing consultants to perform the evaluation.
- Similar legislation for monitoring the actuarial process has operated effectively since 2008 and requires an independent actuary be engaged by the sponsoring governmental entity.

Recommendations for Systems

- The PRB identified several broad themes prevalent within multiple evaluations from both recommendations for improvement and/or existing policies and procedures that align with best practices.
- The recommendations outlined in this section are not presented as suggestions for legislative changes but potential areas for improving existing practice for systems.
- Examples:
  - The use of passive vs. active investments
  - Enhanced documentation and disclosure
  - Benchmarking
  - Investment fee considerations
  - Interaction of asset allocation development, risk analysis and the assumed rate of return

Summary of Investment Practices and Performance Evaluation

Examples

PRB Analysis of Evaluation

Plan Assets[1] $162,766,406

Evaluator: Alpha Consulting Group of Wells Fargo Advisors

Evaluator Disclosures[2]

Qualifications: Undisclosed

Relationship: Investment consultant

Remuneration: Disclosed

Investment Discretion: None

The evaluation identifies the policies and practices the system follows and concludes they are largely in-line with best practices. The evaluation noted that the pension board engaged the investment consultant to perform a "Risk Posture Assessment" in February 2019 to evaluate the system's risk appetite. As a result of the assessment, additional asset classes were added to the portfolio, but the board chose not to add alternative investments.

In general, the statements describing the system policies and practices provide minimal commentary, explanation or comparison to peers. For example, the evaluation states that the asset allocation is reviewed every year to ensure the allocation is in line with the expected return but does not elaborate on the process used to review the asset allocation.

Other notable aspects identified in the evaluation are as follows:

- The asset allocation is crafted to achieve the expected return.
- The system primarily uses active vs. passive managers, which the evaluator notes "have been successful in beating their underlying indexes."
- The evaluation also notes that active manager performance is only compared to benchmarks gross-of-fees, not net-of-fees.

The following table presents key points identified by the evaluator in each section of the evaluation and any recommendations for improvement.

Investment Policy Statement
The Investment Policy is to be reviewed at least annually for its appropriateness. Roles and responsibilities are covered for the Board of Trustees (Board), Investment Managers, Custodian and Investment Consultant. In the Policy, Amarillo Fire is to meet three of their four investment goals over time (not less than three years). The Policy does not take into consideration the current funded status, but it does include the contribution amounts for the City and the participants. The Policy follows industry best practices, but it does not include language about fees. **Recommendations:** - Language should be added to address that investments into mutual funds, exchange-traded funds or comingled investment trusts that may not follow the investment stipulations of the Statement of Investment Policy. - It is recommended that language is added to the Statement of Investment Policy regarding the evaluation of Plan expenses.

[1] As of 12/31/2018
[2] As recommended in the PRB's informal *Guidance for Investment Practices and Performance Evaluation*

Investment Asset Allocation

The Board reviews the asset allocation every year or so and in February 2019 engaged the Investment Consultant to do a Risk Posture Assessment to ensure the System's appetite for risk matches their ability to take risk. The System's asset allocation is crafted to achieve the expected rate of return which is a product of the Investment Consultant and Actuary working together to make sure the expected return is reasonable given current market conditions. The System does use tactical allocations but currently does not use alternative investments which differs from other Plans of similar size. The System primarily uses active managers and has limited exposure to passive investments.

Strengths:

- Risk Posture Assessment, Asset Allocation Study conducted in 2019 providing thorough research

Recommendations:

- None

Investment Fees

The System currently does not have a written policy covering fees. The reasonableness of fees is determined by a 3rd party, Abel Noser, engaged by the Board to provide analysis of the commissions paid. The System has reviewed the cost of the investment managers and other service providers such as the Investment Consultant, Custodian and Legal Advisors.

Recommendations:

- None

Governance

The Board does not have a stand-alone governance policy, but the Board does follow the recommendations of the PRB and TLFFRA guidelines.

Recommendations:

- None

Investment Manager Selection and Monitoring
The Board in consultation with the Investment Consultant is responsible for selecting and retaining investment managers. The Investment Consultant will present to the Board investment managers that are recommended by the consultants Global Manager Research (GMR) analysts. GMR analyzes investment managers using qualitative and quantitative data. When the Board is comparing multiple managers, they will provide an emphasis on managers with attractive risk-adjusted returns, who protect assets in down-markets and have consistent returns. Conflicts of interest for both investment managers and Board members are considered when evaluating managers. - Performance is reviewed quarterly - Overall Plan level and individual investment manager performance is covered - Metrics such as standard deviation, beta and Sharpe ratio are used - Performance is reviewed gross-of-fee (no net-of-fees since the benchmark indexes do not include investment cost) **Recommendations:** - None

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PRB Analysis of Evaluation

Plan Assets[1] $2,041,914,130

Evaluator: Meketa

Evaluator Disclosures[2]

Qualifications: Disclosed

Relationship: Investment consultant

Remuneration: Disclosed

Investment Discretion: None

The evaluation offers a balanced approach to both summarizing key aspects of the System while also going into more detail where necessary. The evaluation provides helpful summary points for each section and recommendations are well-supported with details and comparison to leading practices.

The evaluation provides and explains a recent 2018 stress test that influenced the actions of the Board. In response to the analysis, the Board adopted a Safety Reserve portfolio and is following a risk-based implementation plan designed to minimize the potential impact of a severe near-term market correction.

The evaluation also addresses the unique situation that the System has with its rebalancing effort for its illiquid and alternative investments and recommends increasing passive exposure.

The following table presents key points identified by the evaluator in each section of the evaluation and any recommendations for improvement.

Investment Policy Statement
The Investment Policy Statement (IPS) was reviewed by Dallas Police & Fire Pension (DPFP) Staff, the Investment Advisory Committee (IAC), investment consultant, and the Board. **Strengths:** - The IPS is well-thought-out and in-line (or better) than industry standards - It is consistent with guidance from the CFA Institute - Roles and responsibilities of all key parties involved are clearly outlined (Board of Trustees, Investment Advisory Committee, Executive Director, Investment Staff, Consultants, Investment Managers, Custodian) - The document is written in “plain-English” and easy for a layperson to understand - There is no evidence of any known compliance violations with the IPS at this time **Recommendations:** - The “Core Beliefs and Long-Term Acknowledgments” is thoughtful and should be reviewed at any time significant investment changes are considered. It offers good guidance without being overly prescriptive or prohibitive. - DPFP Staff and the Consultant should continue to conduct an annual review of the IPS.

[1] As of 12/31/2018
[2] As recommended in the PRB’s informal *Guidance for Investment Practices and Performance Evaluation*

Investment Asset Allocation
According to the IPS, "a formal asset allocation study will be conducted as directed by the Board, but at least every three years. Asset allocation targets will be reviewed annually for reasonableness in relation to significant economic and market changes or to changes in the investment objectives. Minimal tactical decisions have been implemented in the past two years. According to the IPS "the Strategic asset allocation determines the risk reward profile of the portfolio and thus drives overall portfolio performance and volatility." DPFP has been 100% active over the recent history. DPFP recently funded its first passive mandate (on a temporary basis). DPFP requires a 2/3 approval of the Board for any new investments in alternative assets. DPFP does not plan to make any illiquid or alternative investments for the foreseeable future as it works to rebalance its portfolio to the new policy asset allocation. DPFP has a significantly lower target weight to illiquid investments (relative to current exposure) and has been working hard over the past few years to reduce its exposure. To be proactive DPFP has been tracking the computation pay relative to the city's hiring plan because if hiring and pensionable compensation do not keep pace with projections less contributions will go into DPFP starting in 2025 after the contribution floor is lifted. Meketa (with data from DPFP's actuary) modeled different asset-liability scenarios in 2018 based on different contribution rates. **Strengths:** - DPFP staff and Board recognize their current exposure is very different from policy weights and have been working very hard to shift the portfolio (out of illiquid investments). - DPFP's current approach to asset allocation (2018) is thorough and robust. - It is on par (or better) than industry standards. - In our opinion, the approach DPFP takes to formulate asset allocation is sound, consistent with best practices, and leads to a well-diversified portfolio. - Current DPFP Staff is doing a commendable job with a very challenging situation, as it works to liquidate private market investments at the best possible price. - DPFP's Board of Trustees' acknowledgment and understanding of the plan's funded status and cash flow situation were crucial data points that helped guide the overriding theme of the most recent asset allocation decision-making process. - As noted previously, the Consultant conducted significant stress testing surrounding the anticipated liabilities of DPFP and the impact of not earning the plan's actuarial return. - In response to the analysis, the Board adopted a Safety Reserve portfolio and is following a risk-based implementation plan designed to minimize the potential impact of a severe near-term market correction.

Recommendations:

- The Board consider increasing passive exposure in efficient asset classes where the likelihood of risk-adjusted outperformance, net of fees, is lowest. A recent survey of similar-sized public pension plans showed that the average passive exposure is 18% of total plan assets.
- DPFP Staff should continue its process of working with the Board and external advisors to prudently exit illiquid investments to the extent possible.
- The Board should remain patient with asset allocation as the portfolio is transitioned and doesn't feel obligated to conduct comprehensive asset allocation overhaul every year. (Surveys have shown many large state plans are moving towards once every three - five years).
- The Board and Staff should closely monitor contribution levels and maintain a constructive and open dialogue with the City.
- If (based on the actuary's advice) it becomes likely that DPFP is not on track to meet targets by 2024, we encourage the Board to act as soon as reasonably possible to discuss and implement additional plan design changes to avoid delaying and compounding any known shortfalls.
- DPFP consider adjusting actuarial valuation assumptions as necessary based on the outcomes and advice of the actuary upon the conclusion of the experience study expected in 2020.

Investment Fees

Fees that are paid via invoice are reviewed by the appropriate DPFP analyst based on the assigned asset class coverage. According to conversations with Staff, the analyst will typically calculate the expected quarterly fee via an excel spreadsheet and reconcile with what is billed by the investment manager. DPFP Staff keeps an excel sheet with all investment related fees paid (direct investment management fees, incentive fees, commissions, custodian fees, investment consultant fees, legal related investment fees). DPFP Staff and Consultant monitor investment manager fees and appropriateness relative to similar investment strategies.

In total, nine of the eleven public markets managers charge less than the median manager for their respective peer groups. Of the two that were more expensive than median, DPFP restructured one of those fee arrangements to a performance-based fee within the past year. DPFP paid a blended average fee of 0.74% bps in calendar year 2018. This is above the industry average of 0.60% (according to the latest available NCPERS survey conducted).

Strengths:

- DPFP has done a good job of identifying public market managers with competitive fees.
- DPFP’s process for reconciling and paying fees appears in-line with industry standards.
- DPFP’s tracking and monitoring of fees appear in-line with industry standards.
- The transparency and disclosure of fees in the annual CAFR are clear and unambiguous.

Recommendations:

- Passive strategies could reduce overall investment-related fees for DPFP fees.
- We recommend continued efforts on seeking no fee or discounted fee arrangements on private market investments that enter extension periods.
- We recommend DPFP staff document its internal process for fee reconciliation and payment in a formal procedure document or memo.

Governance
Most investment related decisions are accompanied by spirited debate between Trustees, Staff and Consultant. The IAC meetings are still in a development phase. All positions on the IAC were recently filled in 4Q19. Its roles and responsibilities are detailed in the IPS but its interplay with the broader Board of Trustees is still yet to be applied in practice. There is very little (to no) "rubber stamping." Monthly meetings are required. DPFP's meeting frequency is standard for public pension meetings. We have conducted surveys of large public pension plans and found that many are moving towards less frequent meetings but more in depth (lengthy) meetings. **Strengths:** - DPFP's website and transparency are better than most similar-sized public pension plans. - DPFP's Staff is appropriately following the rebalancing protocol and does a great job of conveying all rebalance recommendations with appropriate supporting data and rationale. - DPFP's board members are more sophisticated and knowledgeable than most similar-sized public pension plans. - The Board composition appears sufficiently diversified in terms of subject matter expertise. - The meeting minutes (posted to the website) are sufficiently detailed to get a good sense of the discussion and decisions conducted at a meeting. - They are also published in a reasonable amount of time following each meeting (typically within 30 days). **Recommendations:** - To the extent possible, we would like to see increased continuity of Trustees on the Board.

Investment Manager Selection and Monitoring
Meketa has a process where it continuously monitors and reviews investment managers in the industry. From this work, Meketa creates a “bullpen” of high conviction products that have been thoroughly vetted through Meketa’s multi-phase process. According to the IPS, each hiring recommendation will include information on Investment Manager’s organization, key people, investment process, philosophy, past performance, future expectations, risks, proper time horizon for evaluation, comparative measures such as benchmarks and peer groups, role within the relevant asset class and expected costs. While no active managers have been hired during Meketa’s tenure as DPFP’s current consultant, the Consultant typically produces a “search document” that compares and contrasts eligible strategies on the basis of firm ownership/structure, investment teams, investment philosophies, processes/risk management, performance, fees, and strengths & weaknesses. The Consultant produces a quarterly performance report that is shared with Staff, Board of Trustees, and IAC. DPFP Staff and investment consultant are primarily responsible for monitoring the performance of the investment managers and reporting to the Board of Trustees and IAC. **Strengths:** - The evaluation process for new investment manager hires is untested in its current form but appears adequate (as written on paper) and in-line with industry best practices. - DPFP Staff is very knowledgeable and informed on the investment activities of its individual investments and investment managers - Performance monitoring and benchmarking are in-line with industry best practices. - Evaluation (and thoughtful discussion) by DPFP Staff on performance drivers and considerations for the need for any portfolio adjustments are measured, well thought out, and more complete than typical for similar-sized pension plans. **Recommendations:** - We recommend Staff continue to prepare deep-dive reviews into each asset class to cover the entire portfolio in each calendar year - We recommend DPFP formally documents the rationale for all hiring and firing decisions.

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PRB Analysis of Evaluation

Plan Assets[1] $5,674,647,000
Evaluator: Verus
Evaluator Disclosures[2]
Qualifications: Disclosed
Relationship: Independent 3rd Party
Remuneration: Disclosed
Investment Discretion: None

As allowed by Texas Government Code §802.109, the evaluation was prepared in accordance with the Houston Police Officers' Pension System's governing statute. While many of the requirements are like those outlined in §802.109, differences do exist. Most notable are:

1) the evaluator is only required to "review and report" versus "evaluate and provide recommendations" on the topics identified and
2) the "retirement system's governance processes" is not a required topic.

The evaluation provides useful explanations and comparison to leading practices for important topics that ultimately improve the understanding of the system. The report includes an explanation and analysis of the fund's liquidity using a liquidity coverage ratio (LCR).

One aspect noted is the system's large exposure to passive investments compared to its peers, which resulted in lower investment fees. The evaluator also explains that the system is somewhat unique relative to many of its peers in that it does not utilize a general consultant to assist with program implementation, but comments that this aspect has not hindered long-term performance.

The evaluation details that the system's "risk and return objectives are to achieve its actuarial investment rate, currently set at 7.0% net of fees and expenses."

The following table presents key points identified by the evaluator in each section of the evaluation and any recommendations for improvement.

Investment Policy Statement
We found HPOPS takes compliance very seriously, and in most cases, we found that HPOPS closely follows the letter and spirit of its policies. Upon review, we found HPOPS's Ethics Policy to be thorough and comprehensive with sufficient requirements to effectively monitor compliance. In our view, HPOPS is a well-managed plan with a disciplined governance structure, a strong and ethical culture, clear decision-making processes, and a reasonable investment strategy. We found no critical-path practices which we believe would imperil the health and solvency of the Plan. We found HPOPS to be somewhat unique relative to many of its peers in that they do not utilize a general consultant to assist with program implementation. However, this has not hindered their long-term performance, which places them in the top decile among their public fund peers over the long-term. **Recommendations:** - None

[1] As of 6/30/2019
[2] As recommended in the PRB's informal *Guidance for Investment Practices and Performance Evaluation*

Investment Asset Allocation

HPOPS' risk and return objectives are to achieve its actuarial investment rate, currently set at 7.0% net of fees and expenses, within the risk parameters established by the Board. Staff conducts scenario analysis on the policy portfolio against historical market conditions in addition to stress testing high and low capital market assumptions as additional lenses through which to judge the reasonableness of strategic asset allocation. The asset allocation is reviewed frequently in light of current and expected market conditions.

HPOPS' current allocation is tilted toward heavier equity exposure and lower fixed income exposure than its peers, which has served it well as higher risk exposures have been steadily increasing since the Global Financial Crisis. Based on these performance metrics, HPOPS actual allocation as implemented has been highly effective in meeting its return objectives over most historical periods and showing strong performance relative to its peers.

Philosophically, HPOPS believes excess returns produced by active management to be fleeting and difficult to identify in advance. They further recognize the behavioral biases faced by most investors that often lead to hiring a manager at the peak of cyclical performance and terminating at the trough. For these reasons, the Plan utilizes predominantly passive exposure in its public markets investment portfolio, obtained through a combination of index funds, ETFs, and futures positions.

Our analysis based on cash flow projections provided by HPOPS, shows that even under extreme market conditions, the Plan maintains sufficient liquidity to cover net cash outflows.

Recommendations:

- None

Investment Fees

Because of HPOPS' heavy usage of passively managed investment strategies, fees are low compared to peers. In our experience, we find a fee load of approximately 40 -60 basis points, not including private markets, to be reasonable for mid-sized plans with a typical mix of active and passive investments, and HPOPS' fees are well below this level. In 2017, HPOPS commissioned a study by CEM Benchmarking to conduct a thorough review of the Plan's investment management cost. available. The 2017 study conducted by CEM Benchmarking stated that HPOPS' all-in fee load was slightly higher than the average of similarly sized plans in its database. We believe this observation results from the impact of HPOPS' higher allocation to low-cost passive strategies being largely offset by its higher usage of high-cost alternative strategies.

In aggregate, we find HPOPS' fee structure to be reasonable and appropriate given its investment strategy.

Recommendations:

- None

Governance

Section Not Required Per Governing Statute

In our view, HPOPS is a well-managed plan with a disciplined governance structure, a strong and ethical culture, clear decision-making processes, and a reasonable investment strategy. We found no critical-path practices which we believe would imperil the health and solvency of the Plan.

Recommendations:

- None

Investment Manager Selection and Monitoring

Because HPOPS utilizes mostly passive management for its public markets investments, the opportunities to follow the above-described process have been limited. One example occurred in 2013, when the Plan was seeking an “Alternative Beta” manager to help diversify portfolio risk. Based on our review of search documents, this search was not conducted in strict compliance with Investment Policy. Further, in our view actively managed traditional investments, and alternatives each require different approaches to due diligence, including varying degrees of rigor. HPOPS’ established search process does not explicitly address these differences.

We believe these benchmarks are broadly appropriate. We further believe additional useful information could be obtained by comparing each fund to a relevant peer universe of actively managed strategies. Through discussions with Staff, we confirmed that annual meetings occur as mandated but that the reviews are unstructured and not well documented.

Recommendations:

- Specify separate requirements for active and passive traditional investments, as well as for alternative investments.
- Simplify the process description, providing high-level guidelines for flexibility with specificity on required rigor only where necessary. For example, it may not be necessary to have candidate managers complete an RFP for every search, but it may be necessary to obtain Investment Committee and Board approval every time.
- Prepare adequate documentation to ensure/demonstrate process has been followed.
- Include peer rankings in periodic performance reports, as appropriate.
- Clarify the level of due diligence required by type of investment.
- Reduce the specificity of the coverage topics in Appendix G to provide Staff with flexibility.
- Prepare adequate documentation to ensure/demonstrate process has been followed.

5d. Updates on correspondence with certain systems regarding concerns with Investment Practices and Performance Evaluations

6. Date and location of next Investment Committee meeting – TBD

7. Invitation for public comment

8. Adjournment