

Putting clients first.



To: Board of Trustees, Abilene Firemen’s Relief & Retirement Fund Section  
From: Tony Kay, AndCo Consulting, LLC  
Date: April 23, 2020  
Subject: 802.109 Texas Government Code

**(1) Provide 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.**

The Abilene Firemen’s Relief & Retirement Fund (the “Fund”) has an investment policy statement (“IPS”) in place. The Fund’s investments are governed by Section 9.01, Article 6243n-1, Vernon’s Texas Civil Statutes. The IPS outlines the objectives and risk tolerance of the Fund as well as the various management and administration responsibilities related to the management of the Fund’s investment portfolio. The IPS defines that the Board of Trustees (“Board”) is responsible for making decisions regarding the Fund’s investment portfolio. All recommendations for actions in the investment portfolio are reported to and voted on by the Board. The Board has hired an outside investment consultant to assist the Board in their decisions regarding the Fund’s IPS, strategic asset allocation, manager selection, ongoing manager evaluation, and IPS compliance monitoring. An analysis of the IPS’s key elements are outlined in the table below:

Scope & purpose	The purpose, asset base and organizational structure of the System’s investment portfolio are clearly defined.
Governance structure	Roles and responsibilities for decision making, communication requirements, monitoring oversight, applicable law and future IPS modifications are clearly defined.
Investment, return, and risk objectives	Return objectives, risk tolerance, time horizon, asset allocation targets, investment guidelines, and other relevant portfolio considerations are clearly defined.
Risk management	Performance measurement standards, metrics for portfolio and investment manager evaluation, and compliance requirements are clearly defined.

The Board generally reviews the Fund’s IPS at least annually. The last review took place in October of 2019 where changes were made related to the Real Assets and Hedge Fund allocations. The Board also monitors compliance to the Fund’s current IPS during each quarterly performance review with the investment consultant.

We analyzed the Fund’s IPS and the Board’s compliance with the IPS. While different IPS structures exist, AndCo<sup>1</sup>, as an independent, professional investment consulting firm, has determined that the Fund’s IPS, and the Board’s compliance with the IPS, is appropriate and comparable with what AndCo considers best practice, industry standards. No changes are recommended at this time.

**(2) Provide a review of the retirement system's investment asset allocation, including**

**(A) Review of the System’s process for determining target allocations;**

The Fund’s process for determining asset allocation targets is executed and implemented through frequent and thorough discussions between the Board and the investment consultant. Each year, the Board’s investment consultant uses a combination of 10- to 15-year forward-looking asset class return assumptions, risk and correlation assumptions, historical asset class return and risk data, and a long-term (50+ years) building block return methodology to determine a target allocation that the investment consultant believes will have the highest probability of achieving the Fund’s return objectives. Any changes to the Fund’s strategic asset allocation targets and ranges are then recommended to the Board for consideration. This was last reviewed in October 2019.

**(B) Review the expected risk and expected rate of return, categorized by asset class;**

The investment consultant utilizes the 10- to 15-year forward-looking asset class return and risk assumptions produced by a third-party provider, JP Morgan. These 10- to 15-year assumptions are updated annually and have been consistently published for use by asset allocators for 24-years. The investment consultant also maintains an internally developed, stable, long-term (50+ years) building block return methodology for supplemental, long-term asset return assessments. Current year return and risk expectations for each IPS target asset class are detailed in the table below:

Asset Class	10- to 15-year Expected Arithmetic Return*	10- to 15-year Expected Annualized Risk*	Building Block Return Assumption**
Large Cap Equity	6.55%	14.34%	10.00%
Mid Cap Equity	7.12%	16.30%	10.00%
Small Cap Equity	8.12%	18.95%	10.00%
Broad International Equity	9.17%	17.45%	11.00%
Emerging Market Equity	11.15%	21.12%	11.00%
US Core Fixed Income	3.16%	3.42%	5.00%
Non-US Fixed Income	3.54%	6.72%	6.00%
Other Fixed Income	7.88%	13.87%	5.50%
Core Real Estate	6.37%	11.07%	7.00%
Global Infrastructure	6.51%	10.46%	7.00%

\*Source: 2020 JPMorgan Long-term capital market assumptions

\*\*Source: AndCo Consulting

<sup>1</sup> AndCo Consulting is an investment adviser registered with the U.S. Securities and Exchange Commission (“SEC”). Registration as an investment adviser does not constitute an endorsement of the firm by securities regulators nor does it indicate that the adviser has attained a particular level of skill or ability

It is important to note that expected returns do not reflect the impact of active management or contain an expectation of active manager alpha. Projections do assume the underlying asset class returns can be achieved net of fees. Finally, where direct asset class expectations are not available for named IPS target asset classes, these targets are proxied to a similar asset class or combination of asset classes that do have assumptions.

**(C) Review the appropriateness of selection and valuation methodologies of alternative and illiquid assets; and**

The Board relies on the Fund's investment consultant, and the investment consultant's experience, to consider the appropriateness of valuation methodologies used by third-party investment managers that oversee alternative and illiquid assets for the Fund. Further, an analysis of the appropriateness of each manager's written valuation policy for their underlying strategy holdings is generally part of the investment consultant's standard due diligence process when they evaluate these types of strategies for client portfolios. Only strategies deemed to have reasonable and appropriate valuation methodologies will be recommended for potential inclusion in the Fund's portfolio. Neither the Board nor the investment consultant selects the valuation methodology used by third-party investment managers that oversee alternative or illiquid assets. The performance and valuation of all third-party alternative and illiquid investment strategies that are part of the Fund's investment portfolio are also reviewed with the Board as part of the quarterly performance review prepared and presented by the investment consultant. The Board utilizes the same process for the selection of alternative assets as it does for the selection of traditional asset managers. This selection process is detailed in question 4.

**(D) Review the future cash flow and liquidity needs;**

The Fund's cash flow and liquidity needs are reviewed by the Board each quarter as part of the investment consultant's quarterly performance review. This review includes discussions regarding the current, expected, and known timing variances of future contributions to, and withdrawals from, the Fund. Based on the Fund's current cash flow expectations, the portfolio has been positioned to include higher allocations to public, liquid assets.

We reviewed the Fund's processes for asset allocation including; target determination, expected risk and return, selection and valuation methodologies for alternative and illiquid assets, as well as cash flow and liquidity needs. While different approaches exist, AndCo, as an independent, professional investment consulting firm, has determined that the Fund's processes are appropriate and comparable with what AndCo considers best practice, industry standards. No changes are recommended at this time.

**(3) Provide a review of the appropriateness of investment fees and commissions paid by the retirement system;**

The Board reviews the fees (stated in both dollars and basis points) paid to administer the Fund's portfolio on a quarterly basis for each of its underlying investment managers and strategies in the quarterly investment review prepared and presented by the investment consultant. The fees for the Fund's portfolio contained in the most recent quarterly investment review reflect a cost of 0.62%. Based on the 2019 NCPERS Public Retirement Systems Study, published on January 22, 2020, the average fee for the survey's 155 state and local government pension respondents was 0.55%. It is important to note the Fund also considers fees an important part of the decision-

making process and evaluates the potential fee impact for each new investment manager and strategy considered for inclusion in the Fund's portfolio. The Fund considers the current fee of 0.62% reasonable and appropriate for its portfolio. In addition, the Fund is taking steps to reduce the investment fees it pays by increasing exposure to low-cost passive investments and reducing the exposure to higher-cost private assets.

We reviewed the fees paid to administer the Fund's portfolio and the underlying investment manager fees. While high or low fees do not guarantee failure or success for an investment portfolio, AndCo, as an independent, professional investment consulting firm, has determined that the Fund's fees are appropriate and comparable with what AndCo considers best practice, industry standards. No changes are recommended at this time.

**(4) Provide 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**

The Fund's IPS contains clear definitions of the Board's responsibilities as well as the role of the Board's professional advisors in assisting the Board in fulfilling its fiduciary duties to the Fund with respect to the investment of assets. Direct investment authority for the Fund's assets lies with the Board. As such, all decisions regarding the Fund's portfolio including return objectives, risk tolerance, investment guidelines, asset allocation targets and manager selection and retention reside with the Board.

The Board utilizes an investment consultant to assist with setting the Fund's strategic policy and asset allocation targets, as well as, investment manager strategy evaluation and selection. The investment consultant is a fiduciary to the Fund, and all third-party separate account investment managers are required to be fiduciaries to the Fund. In addition, all comingled fund investment managers must be fiduciaries to the fund that they manage in which the Fund has invested. The Fund does not perform any portfolio management functions internally.

Governance for investment activities and related decision-making is a multi-step process. The process generally includes the following:

- a. Recommendations (policy, strategy, or both) are made to the Board by the investment consultant.
- b. The Board reviews, questions and evaluates the investment consultant's recommendation. This process may include a request for clarification, modification, and/or additional information regarding the recommendation. This process may also include investment manager interviews if a series of comparable investment strategies are being considered.
- c. Once a consensus approach on a recommendation has been reached, the final investment recommendation is officially considered by the Board for action.
- d. The Board accepts motions for action and votes to accept or reject those motions.
- e. Once an action is accepted by the Board, the Board's Chairman and Plan Administrator work with the investment consultant to execute the Board's desired investment action or decision, and when necessary, with the Fund's legal counsel for the negotiation and execution of any associated investment agreements.

Board members are active participants in industry educational opportunities such as conferences. Trustees of the Fund follow the requirements of Texas Administrative Code 607. In addition, the investment consultant provides education on investment topics related to the Fund's portfolio or other relevant topics that are of interest to the Board.

We reviewed the Fund's governance processes related to investment activities, investment decision-making, delegation of investment authority, and education. While different governance structures exist around investment decision-making, delegation of investment authority, and education, AndCo, as an independent, professional investment consulting firm, has determined that the Fund's processes are appropriate and comparable with what AndCo considers best practice, industry standards. No changes are recommended at this time.

#### **(5) Review of the retirement system's investment manager selection and monitoring process.**

The investment manager selection process for the Fund is conducted in collaboration with the Fund's investment consultant. Whether a specific investment strategy review is directed by the Board or the strategy idea comes from the investment consultant's research group, all potential investment strategies must go through the consulting firm's due diligence process and subsequently be presented and approved by the investment consultant's Investment Policy Committee before being shown as potential strategies for the Board to consider for the Fund's portfolio. The investment consultant is completely independent from the investment management community and receives no compensation for reviewing or including any managers in the search process, nor does the investment consultant receive any compensation from any investment manager or investment products. Regardless of whether an existing portfolio strategy is being replaced or a new strategy is being considered for the Fund's portfolio, the investment consultant will prepare and present a comprehensive manager evaluation report to the Board that includes candidates for consideration, discussion and subsequent interviews with the Board. From this group, finalists are selected by the board with input from the investment consultant for presentation and ultimate selection by the Fund.

While the investment consultant may make recommendations regarding investment strategies, the ultimate decision to select a specific strategy for inclusion in the Fund's portfolio resides with the Board. Once a decision is made by the Board, legal counsel reviews and assists the Board in the execution of necessary agreements. In addition, if the selection is a separately managed account, the investment consultant will draft an addendum to the IPS for approval by the Board, and signature by the investment manager, that outlines specific objectives, constraints and benchmarks for the portfolio under the discretionary authority of the investment manager.

The ongoing monitoring of investment managers and strategies is also done collaboratively with the Board and the investment consultant on a regular basis (as needed between meetings) and through quarterly Board meetings that the investment consultant attends. The investment consultant prepares summary monthly performance reports and more comprehensive quarterly investment reviews for presentation to, and discussion with, the Board during these quarterly meetings. The investment consultant's reports highlight portfolio and investment manager performance and risk relative to the various performance measurement standards established in the IPS. The criteria established in the IPS tracks managers on both a qualitative and quantitative basis. Strategies that repeatedly fail to meet these standards will be placed on a watchlist or terminated. The criteria are not designed to remove the decision process from the Board, but rather are intended to add objectivity and enhanced scrutiny on managers who are

underperforming the criteria contained in the IPS. While the investment consultant may make recommendations regarding the continued retention or termination of an investment strategy in the Fund's portfolio, the ultimate decision to retain or terminate an investment strategy (within the bindings of the strategy's agreement) resides with the Board.

We reviewed the Fund's investment manager selection and monitoring process. While different approaches to manager selection and monitoring exist, AndCo, as an independent, professional investment consulting firm, has determined that the Fund's selection and monitoring of investment managers are appropriate and comparable with what AndCo considers best practice, industry standards. No changes are recommended at this time.

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### ***Important Disclosure Information***

*This report was prepared at the sole request of the Abilene Firemen's Relief & Retirement Fund. Information presented is typically narrow in scope and provides a general overview of circumstances and processes and should therefore not be construed as exhaustive. AndCo Consulting does not provide legal, tax or accounting advice.*

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