

# Investment Policy or Strategic Investment Plan

2024

Denton Firemen's Relief and Retirement Fund

## Review and Analysis of Investment Policy

1. Does the system have a written investment policy statement (IPS)?
  - a. Yes, policy attached to investment policy.
2. Are the roles and responsibilities of those involved in governance, investing, consulting, monitoring, and custody clearly outlined?
  - a. Yes, section XI of the IPS requires a semi-annual rebalancing review of the policy along with section XIII outlines the options for the Board to engage managers and the responsibilities of the managers.
3. Is the policy carefully designed to meet the real needs and objectives of the retirement plan?
  - a. Yes, section IB of the IPS requires plan to meet or exceed actuarial assumptions.
4. Is the policy written so clearly and explicitly that anyone could manage a portfolio and conform to the desired intentions?
  - a. Yes, the policy is clearly written, and objectives stated in such a way for anyone to manage the portfolio.
5. Does the policy follow industry best practices?
  - a. Yes
6. Does the IPS contain measurable outcomes for managers?
  - a. Yes, Section IB states the total return will equal or exceed actuarial objectives.
7. Is there evidence that the system is following its IPS?
  - a. Yes, portfolio manager reports monthly to the Board and the Board reviews and approves any investments that are outside the policy, if needed.
8. What practices are being followed that are not in, or are counter to, written investment policies and procedures?
  - a. None
9. Are the stated investment objectives being met?
  - a. Yes, as of 12/31/2023 the annual money-weighted net rate of return for the last 5 years per the annual audit (required supplemental information) is as follows:

12/31/2023	9.31%
12/31/2022	(4.54)%
12/31/2021	17.93%

12/31/2020	11.80%
12/31/2019	17.25%

10. Will the retirement fund be able to sustain a commitment to the policies under the stress test scenarios, including those based on the capital markets that have actually been experienced over the past ten, twenty, or thirty years?
  - a. Yes, the Fund has consistently met its goals throughout the history of the Plan. The Plan holds 9.94% of its assets that are illiquid and 12.52% in cash as of 12/31/2023. The fund contains no debt on any of its assets.
  
11. Will the investment managers be able to maintain fidelity to the policy under the same scenarios?
  - a. Yes, the Board meets with the manager on a monthly basis to review the portfolio, the Board approves all changes to the portfolio, except those individual equity's held in mutual funds.
  
12. Will the policy achieve the stated investment objectives under the same scenarios?
  - a. Yes
  
13. How often is the policy reviewed and/or updated?
  - a. The policy is reviewed on an as needed basis. The Investment Policy was last updated February 20, 2020. Portfolio is compared to investment targets on a quarterly basis and Board approval is requested for any variances outside of the target range. During the actuarial process, the portfolio returns are compared to actuarial estimates for comparison and to make sure the stated objectives of the report.

## **Investment Asset Allocation**

### **A. Process for determining target allocations.**

1. Does the system have a formal and/or written policy for determining and evaluating its asset allocation?
  - a. The system does not have a written policy for determining the asset allocation, the investment policy does include an allocation requirement.
  
2. If no formal policy exists, what is occurring in practice?
  - a. In practice the Board is monitoring the allocations on a quarterly basis, the allocation was changed in 2016 to separate alternate investments and create a real estate category.
  
3. Who is responsible for making the decisions regarding strategic asset allocation?
  - a. The Board approves all changes.

4. How is the system's overall risk tolerance expressed and measured? What methodology is used to determine and evaluate strategic asset allocation?
  - a. The Fund uses no formal stress testing model. All decisions are made at the Board level, based on qualitative discussion not quantitative.
  
5. How often is the strategic asset allocation reviewed?
  - a. The plan compares its rate of return with the actuarial assumptions on a bi-annual basis as well as ongoing quarterly review at the Board level.
  
6. Do the system's investment consultants and actuaries communicate regarding their respective future expectations?
  - a. The investment consultant participates in the actuarial study to determine if reasonable expectations are being set and if the ability to meet those expectations are addressed.
  
7. How does the current assumed rate of return used for discounting plan liabilities factor into the discussion and decision-making associated with setting the asset allocation? Is the actuarial expected return on assets a function of the asset allocation or has the asset allocation been chose to meet the desired actuarial expected return on assets?
  - a. In 2015 the assumed rate of return was lowered by the Board to 6.75% from 7%, although the rate of return was lowered, the allocation was not changed. The rate was lowered to take a more conservative approach to future plan performance and liability.
  
8. Is the asset allocation approach used by the system based on a specific methodology? Is this methodology prudent, recognized as best practice, and consistently applied?
  - a. No specific methodology is used; however, the allocation is reviewed based on qualitative discussion at the Board level. The allocation could be considered best practice as performance of the portfolio has been more than adequate to meet future liabilities based on current standards and requirements.
  
9. Does the system implement tactical asset allocation? If so, what methodology is used to determine tactical asset allocation? Who is responsible for making decisions regarding tactical asset allocation?
  - a. See response to question 4 and 8 under Investment Asset Allocation.
  
10. How does the asset allocation compare to peer systems?
  - a. The allocation is similar to those in our peer group.

**A. The Expected Risk and Rate of Return, Categorized by Asset Class**

11. What are the strategic and tactical allocations?
  - a. Strategic Asset Allocation per the 2020 IPS (allowable range shown in parentheses)
    - Domestic Large-Cap                    40%    (25-50%)
    - Domestic Small & Mid-Cap        10%    (5-15%)
    - International Equity                10%    (5-15%)

- Fixed Income 15% (5-20%)
- Cash and Equivalents 2% (1-15%)
- Alternative Investments 8% (5-10%)
- Real Estate 15% (10-20%)

12. What is the expected risk and expected rate of return of each asset class?

- a. The fund does not have a quantitative policy for expected rate of return for each asset class. The return would be measured among all asset classes and the performance of the Fund.

13. How is this risk measured and how are the expected rates of return determined? What is the time horizon?

- a. See answer 12, however the asset classes are compared to various benchmarks.

- Domestic Large-Cap S&P 500
- Domestic Small Mid-Cap Russell 2000
- International Developed MSCI EAFE Index
- MLP's Alerian MLP Index

- b. The fund is managed on a qualitative approach looking at overall investment performance. Investment changes are approved by the Board on a monthly basis.

14. What mix of assets is necessary to achieve the plan's investment return and risk objectives?

- a. See asset allocation under XI (Allocation of Assets) in the IPS

15. What consideration is given to active vs. passive management?

- a. The Plan is a hybrid approach, it is actively managed, but not rebalanced if outside the approved ranges. Rebalancing is a result of new assets being purchased and others sold to maintain the allocation. Specific assets are bought and sold, not as a percentage of portfolio, but on a qualitative approach. Board approves all changes.

16. Is the approach used by the system to formulate asset allocation strategies sound, consistent with best practices, and does it result in a well-diversified portfolio?

- a. Yes, the long-term performance of the fund has been sufficient to meet the needs of the fund as well as maintain an amortization period of less than 20 years.

17. How often are the strategic and tactical allocations reviewed?

- a. Quarterly

**B. The Appropriateness of Selection and Valuation Methodologies of Alternative and Illiquid Assets**

18. How are alternative and illiquid assets selected, measured, and evaluated?
- a. Alternative investments (MLP's) are selected based on yield ability to recover after a down market. Real estate is selected based on locality, ability to purchase without debt and cash flow. Like all assets they are measured and evaluated on a monthly basis.
19. Are the system's alternative investments appropriate given its size and level of investment expertise? Does the IPS outline the specific types of alternative and illiquid investments allowed, as well as the maximum allocation allowable?
- a. The alternative target is 8% and real estate is 15%, which is an appropriate amount for the fund. As of December 31, 2023, the value was equal to 15.5% of the portfolio.
  - b. Alternative investments are specially identified in the IPS under section IX. Real estate is also specially identified in section X of the IPS. All real estate recommendations must be recommended by the real estate committee and approved by a super-majority.
20. What valuation methodologies are used to measure alternative and illiquid assets?
- a. MLP's are compared to the Alerian MLP index, while real estate is reviewed annual based on the capitalization rate. A real estate management company is used to provide monthly accounting as well as lease review. Real estate properties biannually.

**C. Future Cashflow and Liquidity Needs**

21. What are the plan's anticipated future cash flow and liquidity needs? Is this based on an open or closed group projection?
- a. As of the most recent actuarial valuation report (12/31/23), the unfunded actuarial accrued liability is \$14,816,720, or 6.5 years. The funding ratio is 91.1%. Currently the fund has a positive annual cash flow to apply to the future liability. It is based on an open group projection. 8.94% of payroll is available to amortize the UAAL, per the 12/31/2023 actuarial study.
22. When was the last time an asset-liability study was performed?
- a. The last review would be the 12/31/2023 actuarial study and the 12/31/2023 annual audit. The Fund does not perform a formal separate asset-liability study.
23. How are system-specific issues incorporated in the asset allocation process? What is the current funded status of the plan and what impact does it have? What changes should be considered when the plan is severely underfunded, approaching full funding, or in a surplus? How does the difference between expected short-term inflows (contributions, dividends,

interest, etc.) and outflows (distributions and expenses) impact the allocation? How does the underlying nature of the liabilities impact the allocation (e.g., pay-based vs. flat \$ benefit, automatic COLAs, DROP, etc.)?

- a. System-specific issues are incorporated and addressed during the actuarial process. The Plan had already begun considering changes by lowering the rate of return to 6.75% in the 2015 actuarial study. The City and Members work with the Fund using meet and confer agreement to ensure appropriate resources are allocated to maintain funding levels.

24. What types of stress testing are incorporated in the process?

- a. There is no formal stress testing on the process except for the actuarial study.

### **Review of Investment Fees and Commissions Paid**

1. Do the system's policies describe the management and monitoring of direct and indirect compensation paid to investment managers and other service providers? What direct and indirect investment fees and commissions are paid by the system?
  - a. The IPS does not directly address the system's policies and procedures with respect to direct and indirect compensation paid to investment managers. The fees are managed under separate contract with the investment advisor. The current rate is .2% of asset value excluding real estate, cash, and cash equivalents.
2. Who is responsible for monitoring and reporting fees to the board? Is this responsibility clearly defined in the system's investment policies?
  - a. The Plan Administrator monitors and reports investment fees to the board. The fees are approved by the Board and paid separately and not withdrawn by the advisor. The Board is responsible for the monitoring of all other fees incurred by the plan.
3. Are all forms of manager compensation included in reported fees?
  - a. Yes
4. How do these fees compare to peer group and industry averages for similar services? How are the fee benchmarks determined?
  - a. Based on the 2022 TLFRA Annual Pension Report for plans over \$100 million, of those reporting investment fees the fund was below the average. .34% compared to .42%. This does not include mutual fund fees included in the investment return.
5. Does the system have appropriate policies and procedures in place to account for and control investment expenses and other asset management fees?
  - a. Yes, the Board selects the fund manager and approves fees. Fees are approved on a quarterly basis.
6. What other fees are incurred by the system that are not directly related to the management of the portfolio?

- a. Other fees incurred by the system include administration fees, audit fees, actuarial fees, custodial fees, website subscriptions, and legal fees.
7. How often are the fees reviewed for reasonableness?
- a. All fees are reviewed by the Board on an annual basis as well as annually with the yearly audit.
8. Is an attorney reviewing any investment fee arrangements for alternative investments?
- a. No

## **Review of Governance Processes Related to Investment Activities**

### **Transparency**

1. Does the system have a written governance policy statement outlining the governance structure? Is it a stand-alone document or part of the IPS?
  - a. It is part of the investment policy.
2. Are all investment-related policy statements easily accessible by the plan members and the public (e.g., posted to system website)?
  - a. Yes, all investment-related policy statements are accessible to the plan members via the system website.
3. How often are board meetings? What are the primary topics of discussion? How much time, detail, and discussion are devoted to investment issues?
  - a. Meetings are held monthly by board members per TLFFRA. Discussion is generally related to commercial real estate performance/management and the investment portfolio. The majority of the meeting is dedicated to investment issues.
4. Are meeting agendas and minutes available to the public? How detailed are the minutes?
  - a. Yes, meeting agendas and minutes are available to the public. The minutes are detailed sufficiently to describe the agenda.

### **Investment Knowledge/Expertise**

5. What are the backgrounds of the board members? Are there any investment-related educational requirements for board members?
  - a. Derek Oswald (Chairman)- Board member since 2012, chairman since 2013. He has been employed with the City of Denton Fire Department since 1995.  
Gerald Friend (Vice-chair) – Board member since 2022, officer since 2022. He has been employed with the City of Denton Fire Department since 2015.  
Scott Manes (Secretary) – Board member since 2014, officer since 2014. He has been employed by the City of Denton Fire Department since 1998.  
Dick Smith – Board member since 2005, entrepreneur, real estate investor  
Charlie Parker, CFA – Board member since 2006, real estate investor  
Mayor appointee – vacant  
Jessica Williams, – Board member since 2024, City of Denton Chief Finance Officer

- b. Educational requirements are based on Texas Pension Review Board MET requirements.
- 6. What training is provided and/or required of new board members? How frequently are board members provided investment-related education?
  - a. Board members are required to meet the state education requirements.
- 7. What are the minimum ethics, governance, and investment education requirements? Have all board members satisfied these minimum requirements?
  - a. Minimum requirements are based on Texas Pension Review Board MET requirements.
- 8. Does the system apply adequate policies and/or procedures to help ensure that all board members understand their fiduciary responsibilities?
  - a. The IPS does not specifically identify Board policies and procedures.
- 9. What is the investment management model (i.e., internal vs. external investment managers)?
  - a. Internal management occurs through one investment advisor meeting with the Board on a monthly basis and does not exercise discretionary authority. External investment management occurs through mutual funds (10% of portfolio).
- 10. Does the board receive impartial investment advice and guidance?
  - a. Yes, the Board receives impartial investment advice from the investment consultant.
- 11. How frequently is an RFP issued for investment consultant services?
  - a. The Board has not issued an RFP.

### **Accountability**

- 12. How is the leadership of the board and committee(s), if any, selected?
  - a. The Board of Trustees consists of the mayor's appointee from the municipality, the chief finance officer, three elected members of the fire department and two citizens based on the following:
    - Mayor appointee – mayor appointee a member with no term limit.
    - Chief Finance Officer – current chief finance officer for the city
    - Three elected fire department members – elected by other pension members one every year with 3-year terms.
    - Citizen appointees – Appointed by Pension Board for 2-year terms.
- 13. Who is responsible for making decisions regarding investments, including manager selection and asset allocation? How is authority allocated between the full board, a portion of the board (e.g., an investment committee), and internal staff members and/or outside consultants? Does the IPS clearly outline this information? Is the board consistent in its use of this structure/delegation of authority?



- a. The Board is responsible for ultimate approval regarding manager selection and asset allocation with the investment consultant making the recommendations. Full authority is granted through the voting process by the Board.
14. Does the system have policies in place to review the effectiveness of its investment program, including the roles of the board, internal staff, and outside consultants?
- a. Yes, section IV (Investment Philosophy) of the IPS clearly defines these guidelines as well as the annual audit and actuarial study.
15. Is the current governance structure striking a good balance between risk and efficiency?
- a. The system's governance structure is outlined through Vernon's Civil Statutes which serves as the de facto codifications of the Texas Constitution. Article 6243e is specific to the Texas Local Fire Fighters Retirement Act which describes the structure and laws with which the system must follow.

As it relates to risk, the roles and responsibilities of each party involved in the management of the plan are clearly defined in the IPS. In short, the Board is responsible for developing the investment objectives of the plan, hiring of all parties, allocating assets, review of investment results and investment policy.

This structure is quite common throughout the industry and serves as a good system of checks and balances.

16. What controls are in place to ensure policies are being followed?
- a. The best control in place are the roles and responsibilities outlined in the IPS. The IPS is critical to ensure the policy objectives are being met. Additionally, the monitoring and review of the plan on a quarterly basis (at a minimum) with the investment consultant is a good control to ensure policies are being followed.
17. How is overall portfolio performance monitored by the board?
- a. The portfolio performance is evaluated each month and is in compliance with the requirements under the IPS. The investment consultant reports on performance monthly and details performance versus the relevant.
18. How often are the investment governance processes reviewed for continued appropriateness?
- a. Governance processes are reviewed on an as needed basis and discussed during the monthly meeting when appropriate.

### **Review of Investment Manager Selection and Monitoring Process**

- 1. Who is responsible for selecting investment managers?
  - a. The Board is responsible for approval of the investment managers.

2. How are the managers identified as potential candidates?
  - a. The primary advisor identifies potential advisors for allocation purposes.
3. What are the selection criteria for including potential candidates?
  - a. The Board approves all advisors.
4. What are the selection criteria when deciding between multiple candidates?
  - a. The Board only evaluates specific advisors to meet the needs of a particular component of the allocation, the primary advisor does not submit multiple candidates.
5. How does the selection process address ethical considerations and potential conflicts of interest for both investment managers and board members?
  - a. See question 4.
6. Who is responsible for developing and/or reviewing investment consultant and/or manager contracts?
  - a. It is the Board's responsibility to develop and review the investment consultant and investment manager contracts.
7. What is the process for monitoring individual and overall fund performance?
  - a. The Board monitors the performance on a monthly basis and compares it with various benchmarks.
8. Who is responsible for measuring the performance?
  - a. The Board is ultimately responsible for measuring the performance of the plan with the advisor's input.
9. What benchmarks are used to evaluate performance?
  - a. Please refer to the attached monthly performance reports which detail the policy benchmark (and individual asset class benchmarks) including portfolio vs. benchmark returns.
10. What types of performance evaluation reports are provided to the board? Are they provided in a digestible format accessible to trustees with differing levels of investment knowledge/expertise?
  - a. Reports are sent electronically to the Board before the meeting and in hard copy at the meeting. All reports go to all members.
11. How frequently is net-of-fee and gross-of-fee investment manager performance reviewed? Is net- of-fee and gross-of-fee manager performance compared against benchmarks and/or peers?
  - a. Performance is reviewed based on gross-of-fee monthly and net-of-fee during the annual audit.

12. What is the process for determining when an investment manager should be replaced?
  - a. The manager reports to the Board on a monthly basis that if performance were to not meet actuarial rates of return over an extended period the Board will review the manager for replacement.
13. How is individual performance evaluation integrated with other investment decisions such as asset allocation and investment risk decisions?
  - a. The Board reviews the investments and asset allocation monthly for performance review.

## **Executive Summary**

Gary Calmes, PLLC completed an analysis of the investment practices and governance policies on behalf of the Denton Firefighter's Relief and Retirement Fund as required by Texas Code 802.19, created by Senate Bill 322 and applicable to Texas Public Retirement Systems.

The Denton Firemen's Relief and Retirement Fund (DFRRF) is governed by its Investment Policy, which serves as a guide for investment structure to meet plan liabilities. DFRRF's strongest area is its stable environment including long term Board members. The two citizen members have been on the Board for over ten years. The Board has seen little turnover in the past 10 years including the firefighter members/officers. The current investment advisor has been with the plan since 2018, the previous advisor managed the plan for approximately 30 years. The investment advisor is not a large firm but an individual, which means the consistent nature has not changed. The current advisor also collaborated with the previous advisor for two years before taking over.

The practice of the fund is to make investment decisions monthly. Even though the advisor has discretionary authority, it is not used. At the monthly meetings, the advisor updates the Board on market conditions, as well as relative data regarding current investments and performance data compared to various indices. The advisor makes recommendations that must be approved by the Board before being executed. Though the Board does not have a formal review process of the advisor, because of the current practice of investment approval, this does not seem to be an area we would recommend changing.

DFRRF fees and commissions remain low compared to other funds. The fund investment expenses are fee based only plus ticket charges when incurred. DFRRF remains one of the lower cost funds in TLFFRA.

One area we would recommend the Board review is the process by which investments are presented to the Board. The investment advisor presents investment opportunities to the Board, but there does not exist a matrix by which these are chosen. We do not recommend a change in policy but at a minimum discussion as to why and how various investments are chosen.

We found the fund to be very solid with good policies and practices. The DFRRF's solid investment choices, lowering of its actuarial rate of return, and no debt practice for real estate investments make it a benchmark for other funds.

### **Independent Fiduciary Advisor Attestation**

- Gary Calmes PLLC dba Calmes Financial is a Denton-based financial services firm. The firm provides tax and financial planning services as well as consulting services for institutional clients. The firm's principal is a CPA, CFP®, and Investment Advisor Representative.
- Gary Calmes, PLLC serves as the Independent Plan Administrator for the Denton Firemen's Relief and Retirement Fund.
- Remuneration for firm from other sources include fees from clients and no third-party sources.
- Gary Calmes, PLLC does not directly or indirectly manage investments in the system.