

**Investment Practices and Performance Evaluation
of the
Dallas County Hospital District's
Defined Benefit Plan**

April 10, 2023

Introduction: Anodos Advisors (“Anodos”) has been engaged by the Dallas County Hospital District d/b/a Parkland Health (the “System”) to conduct the Investment Practices and Performance Evaluation (“IPPE”) of the District’s Defined Benefit Plan (the “Plan”) called for by the Texas Government Code at Section 802.109. The format of our report is based on the organization of this government code; we recite in order each code subsection then directly respond to each subsection to demonstrate compliance or non-compliance. Additionally, we respond to questions posed by the TPRB in their October 6, 2022 guidance document, which is intended to support systems when conducting the IPPE.

(1) Section 802.109(a) directs that the system “... shall select an independent firm with substantial experience in evaluating institutional investment practices and performance 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.”

- a. Anodos is a fiduciary governance consulting firm. We help our clients develop, maintain, and review their governance policies, procedures and practices related to the investment capital they are responsible for. This is the only work we do. We don’t manage assets. We don’t provide investment consulting services. We don’t provide actuarial services. Investment governance consulting is our only service offering.

(2) Section 802.109(a)(1) directs that the report must include “... a summary of the independent firm's experience in evaluating institutional investment practices and performance and a statement that the firm's experience meets the experience required by this subsection.”

- a. Following is a summary of other governance engagements which demonstrate our familiarity with authoring reports similar to the Investment Practices and Performance Evaluation (IPPE).
 - i. **Parkland Health (2020)** - IPPE required by state statute to evaluate the appropriateness, adequacy and effectiveness of the retirement system’s investment practices and performance and to make recommendations for improving the system’s investment policies, procedures and practices.
 - ii. **Alaska Pension Review Board (2019)** – Audit of the Performance and Investment Consultant for \$27b plan, evaluating whether the work product provided by the fund’s Consultant equipped the Board to fulfill their various fiduciary duties and governance protocols.

- iii. **Colorado Public Employees' Retirement Association (2015)** - Various fee related investigations defined by the COPERA Internal Audit Department.
 - iv. **Alaska Pension Review Board (2014)** – Audit of the Performance and Investment Consultant, evaluating whether the work product provided by the fund's Consultant equipped the Board to fulfill their various fiduciary duties and governance protocols.
 - b. Our experience serving public pension funds meets the experience required to conduct this evaluation and author the Investment Practices and Performance Evaluation.
- (3) Section 802.109(a)(2) directs that the report must include "... a statement indicating the nature of any existing relationship between the independent firm and the public retirement system and confirming that the firm and any related entity are not involved in directly or indirectly managing the investments of the system."
 - a. Anodos does have a prior relationship with the System. Anodos conducted the initial IPPE for the System in 2020.
 - b. Neither Anodos nor any other related party or entity is involved in the direct or indirect management of investments for the System.
- (4) Section 802.109(a)(3) directs that the report must include "... a list of the types of remuneration received by the independent firm from sources other than the public retirement system for services provided to the system."
 - a. Anodos has received no form of remuneration, compensation or benefit from any party other than the System for the services we have provided to the System.
- (5) Section 802.109(a)(4) directs that the report must include "... a statement identifying any potential conflict of interest or any appearance of a conflict of interest that could impact the analysis included in the evaluation due to an existing relationship between the independent firm and (A) the public retirement system; or (B) any current or former member of the governing body of the system."
 - a. There are no potential conflicts of interest nor appearance of any conflicts of interest that could interfere with this review of the System's investment policies, procedures, and practices.

- b. Anodos has no existing or prior relationships with the System other than the authorship of the IPPE in 2020 nor any current or former member of the governing body of the System.
- (6) Section 802.109(a)(5)(A) directs that the report must include “... an analysis of any investment policy or strategic investment plan adopted by the retirement system and the retirement system's compliance with that policy or plan.”
- a. **Investment Policy Statement:** The most recent version of the System’s Investment Policy Statement (“IPS”) was adopted in March 2021 and was filed with the TPRB per §802.202(d)(3) via email.
- b. **Organization:** The IPS is organized consistent with the “best practices” identified by the CFA Institute¹, GFOA, and TPRB², including sections regarding (1) investment principles, (2) objectives (3) approved allocation, (4) manager selection process, and (5) monitoring functions and key performance indicators.
- c. **Investment Objectives:** The investment policy clearly defines three performance objectives for the Plan. These objectives are, over a 5-year period to (1) meet or exceed the actuarial assumed return, (2) meet or exceed the return of the Policy Index, and (3) experience comparable volatility of returns – as measured by standard deviation – of the Policy Index.³ During that 5-year period between q4-2017 and q3-2022 (the end date of this report) the Plan statistics have been as follows:
- i. The Plan’s five-year return net of fee⁴ of 3.79% was lower than the actuarial assumed return of 6.0%.⁵
- ii. The Plan’s five-year return gross of fee of 4.10% was slightly higher than the return of the Policy Index of 3.92%.⁶

¹ Bailey, Jeffrey V. and Richards, Thomas M., *A Primer for Investment Trustees: Second Edition*, CFA Institute Research Foundation, 2017 (Also accessible at <https://www.cfainstitute.org/-/media/documents/book/rf-publication/2017/rf-v2017-n3-1.ashx>)

² “Investment Policies – Texas Pension Review Board.” Texas Pension Review Board. <https://www.prb.texas.gov/investments/investment-policies/>. Accessed 6 Mar. 2023.

³ Investment Policy Statement dtd 3/31/2021, Page 16

⁴ We report “net-of-fee” return when comparing against the actuarial assumed return, though the IPS does not specify whether to compare against gross or net. However, the Actuarial Assumed Return noted in PRB-1000 is an assumed return “net of investment fees”.

⁵ Callan Quarterly Review dtd 9/30/2022, Page 12

⁶ Ibid

- iii. The Plan's five-year standard deviation is approximately 13.5% as compared with the Policy Index 13.0%.⁷
 - iv. The Plan's gross-of-fee five-year return of 4.10% ranked below the median peer group of 4.78%.⁸ (Net-of-fee peer group return is not provided in the Callan reports.)
 - v. We are not overly concerned with the recent underperformance of the Plan's five-year return to the actuarial assumed return. The since inception gross-of-fee return of 6.16% exceeds the actuarial objective of 6.0%.⁹ (Net-of-fee Fund returns since inception of April 2003 is not available.)
 - vi. **Recommended Update to IPS:** We recommend that when comparing the Plan's return to the actuarial assumed return, the Plan's return be reported net-of-fee.
- d. **Delegation:** The delegations of the roles and responsibilities between the governing body (the Budget and Finance Committee, hereafter "B&FC"), the Investment Committee, Staff, the Investment Consultant (Callan) and the various investment managers are clearly defined in the IPS.¹⁰ The scope of authority for each party and the means of measuring each party's activities are clear and unambiguous.
- e. **Selecting and Monitoring Investment Managers:** The IPS defines several criteria for selecting active investment managers and key performance indicators for monitoring these managers.
- i. **Selection Criteria:** The IPS requires that each investment manager have (1) a clearly defined investment philosophy, (2) robust organizational and staffing resource to effectively implement their investment strategy, (3) sufficient assets under management to demonstrate competency, (4) a sufficient track record to demonstrate competency, and (5) management fees that are reasonable.¹¹
 - ii. **Key Performance Indicators:** The IPS requires that each active manager (1) rank in the top 50% of an appropriate peer group, (2) meet or exceed

⁷ Callan Quarterly Review dtd 9/30/2022, Page 25.

⁸ Ibid, Page 23

⁹ Ibid, Page 12

¹⁰ Investment Policy Statement dtd 3/31/2021, Pages 2-6

¹¹ Ibid, Page 7

the return outcomes for the policy index net of fees, (3) maintain a risk level – as measured by standard deviation – comparable to the benchmark index, and (4) meet any other particular guidelines applicable to the managers.¹²

- f. **Adherence to the IPS:** We have carefully reviewed the Investment Committee minutes, Quarterly Performance Reports produced by the Investment Consultant and other work product provided by staff for the one-year measuring period between October 1, 2021 and September 30, 2022. From this investigation we conclude that the System is following its own policies and procedures which are memorialized within the IPS.
 - g. **Stress Test:** Since the initial IPPE was completed in q1 2020, the Plan has experienced an unusually high level of volatility from both the equity markets and the fixed income markets (Covid Crash q2 2020 and Fed Tightening 2022). This “real world” stress test has demonstrated that the governance instructions within the IPS are clear as evidenced by the B&FC’s faithful adherence to the instructions within the IPS. Also, the Treasury Director has exercised a disciplined application of the rebalance instructions within the IPS. Finally, the B&FC has reaffirmed the long-term risk expectations and return objectives for the Plan in total and for each of the asset classes and managers that make up the total. For these reasons we conclude that the instructions within the IPS are clear and consistently applied.
 - h. **Efficacy of Policy Instructions:** In our professional and independent opinion, if the policies are followed, the investment objectives will be accomplished if market conditions in the future are similar to those of the past, with a 5% long-term “real” return from equity and 1% long-term “real” return from fixed income.
 - i. **Investment Manager’s Fidelity to the IPS:** The Individual Manager Guidelines¹³ are unambiguous. In our view there are sufficient policy instructions for the Investment Consultant, Staff and/or the Investment Committee to monitor the investment managers’ fidelity to these instructions.
- (7) Section 802.109(a)(5)(B)(i) directs that the report must include “... a detailed review of the retirement system's... process for determining target allocations.”

¹² Investment Policy Statement dtd 3/31/2021, Page 17

¹³ Ibid, Pages 19-22

- a. **Asset Allocation:** The System has adopted a Strategic Asset Allocation for deploying the Plan’s capital.¹⁴ The allocation among and between asset classes has been carefully developed by the Investment Committee in close collaboration with the Investment Consultant. The Investment Committee has affirmed to the B&FC that “the Plan’s desired investment objective has a strong probability of being achieved with an acceptable level of risk” if the Plan adheres to the current Strategic Asset Allocation.¹⁵
- b. **Allocation Methodology:** The methodology used to develop the approved allocation is based on long established and prudent process which includes (1) defining the performance objective (return target and risk expectations), (2) establishing capital market expectations of the various recognized asset classes, (3) modeling combinations of these assets classes to develop a series of allocation that are reasonably expected to accomplish the return objectives within acceptable risk expectations, (4) considering the prevailing economic environment, and (5) selecting that allocation of asset classes that is reasonably expected to accomplish the Plan’s goals.¹⁶
- c. **Actuarial Assumed Rate of Return, aka Target Return:** The actuarial assumed return used to determine the System’s funding liability is established by the B&FC based on input by the Investment Consultant and the Actuary. Then the asset allocation believed to reasonably accomplish this return objective is adopted. In January of 2020, the B&FC established the actuarial assumed return – the long-term targeted return for the plan – to be 6.0%.¹⁷
- d. **Strategic Asset Allocation:** A copy of the current approved Strategic Asset Allocation follows.¹⁸

¹⁴ Investment Policy Statement dtd 3/31/2021, Page 9-10

¹⁵ Ibid, Page 9

¹⁶ Bailey, Jeffrey V. and Richards, Thomas M., *A Primer for Investment Trustees: Second Edition*, CFA Institute Research Foundation, 2017 (Also accessible at <https://www.cfainstitute.org/-/media/documents/book/rf-publication/2017/rf-v2017-n3-1.ashx>)

¹⁷ PRB – Investment Returns and Assumptions Report PRB-1000, Page 1

¹⁸ Investment Policy Statement dtd 3/31/2021, Page 100

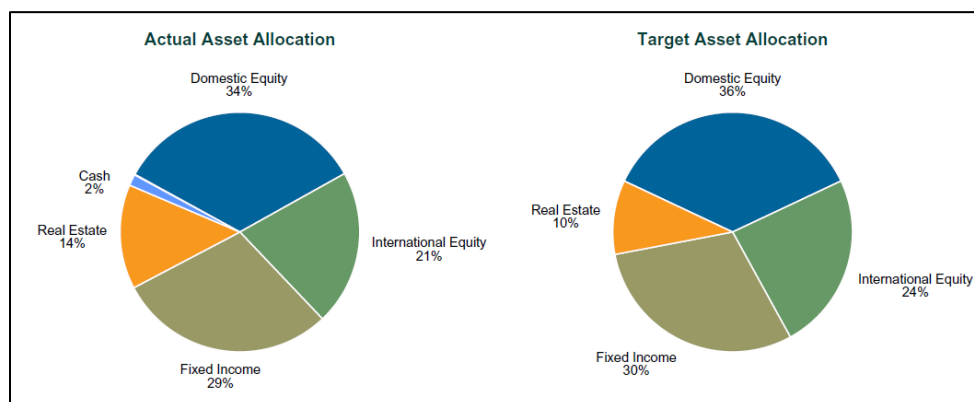
Asset Class	Strategic Target	Allowable Range
Total U.S. Equity	36%	31% - 41%
Large Cap Domestic Equity	26.7%	22.7% - 30.7%
Small/Mid Cap Domestic Equity (Growth & Value)	9.3%	6.3% - 12.3%
Total Non-U.S. Equity	24%	19% - 29%
Non-U.S. Equity	16%	12% - 20%
Non-U.S. Small Cap Equity	4%	2% - 6%
Emerging Market Equity	4%	2% - 6%
Total Fixed Income	30%	26% - 34%
Core Fixed Income	20%	16% - 24%
Core Plus Fixed Income	10%	8% - 12%
Private Real Estate	10%	7% - 13%

- e. **Risk Tolerance:** The System’s risk expectation is expressed as the standard deviation of quarterly returns of the Plan over the preceding five years and is compared against the risk of the Policy Index (a blended benchmark index consistent with the approved allocation).¹⁹ As noted above, the Plan’s 5-year standard deviation is not noted in the Callan report, but the 10-year standard deviation of 10.26% is reported which is reasonably close to the 10-year standard deviation of the Policy Index of 9.81%²⁰. In February of 2022, the Investment Consultant projected that the Strategic Allocation would have a 10-year standard deviation of 11.8% and a Sharpe Ratio of 0.37.
- f. **Review and Modification of the Strategic Allocation:** The projected risk and return of the Strategic Allocation are reviewed annually by the Investment Committee, Investment Consultant and Staff and reaffirmed by the B&FC. A record of this review and reaffirmation is memorialized in the minutes of the Investment Committee and B&FC. This review is based on the updated capital market assumptions (projected risk, return and correlation of the asset class) developed by the Investment Consultant and the capital market expectations of the Actuary (Milliman). When there is a material incongruence between the Strategic Allocation’s projected future return and risk and the Actuarial Assumed Return, the Investment Consultant will suggest modifications to the Strategic Allocation. These changes are made infrequently and cautiously. Since the last IPPE in 2020, no changes to the Strategic Allocation have been made.

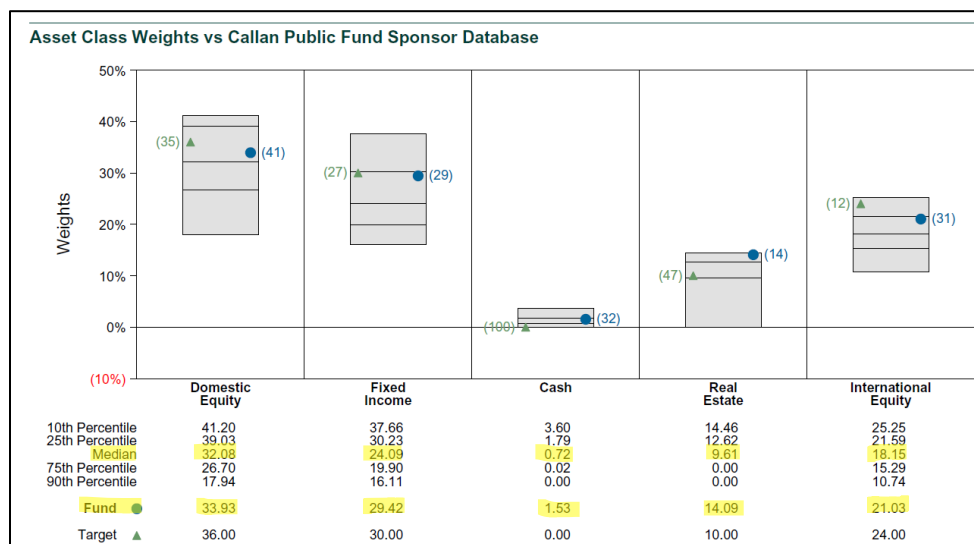
¹⁹ Investment Policy Statement dtd 3/31/2021, Page 16.

²⁰ Callan Quarterly Review dtd 9/30/2022, Page 22.

- g. **Strategic Allocation vs. Tactical Allocation:** The System does not have a Tactical Allocation as distinct from the approved Strategic Allocation – sometimes referred to also as the Target Allocation. Because exactly matching the Strategic Allocation is impracticable given the dynamic nature of the capital markets, the System has approved an Allowable Range that each asset class may deviate from the Target Allocation for that asset class. These deviations are modest and reviewed quarterly by the B&FC, Investment Committee, and Investment Consultant. An example from the Callan 2022-q3 report follows:



- h. **Allocation vs. Peer Group:** The System’s asset allocation is compared quarterly to a peer group of other public funds with similar long-term objectives. The Fund’s current allocation is substantially similar to the median peer group allocation as reported by Callan.



- (8) Section 802.109(a)(5)(B)(ii) directs that the report must include “... a detailed review of the... expected risk and expected rate of return, categorized by asset class.”
- a. **Risk and Return Expectations by Asset Class:** The expected risk and return for each asset class are estimated by the Investment Consultant based on their capital markets assumptions which were presented to the Investment Committee in February of 2022.²¹
 - b. **Prudence of Allocation Methodology:** The approach used to formulate the asset allocation is prudent. Primary design considerations are offered by the Investment Consultant and affirmed by the Investment Committee before the B&FC adopts the proposed design. The result is a well-diversified portfolio. The capital market assumptions used by the Investment Consultant are compared to the capital markets assumptions made by the System’s Actuary in their annual report dated November 11, 2022.²² Both are substantially similar, and each supports the long-term expectation that the current allocation will produce the targeted 6.0% rate of return.
 - c. **Passive vs. Active Management:** No expressed policy on passive management has been made. In practice, passive management is used for the U.S. Large Cap asset class, and active management is used in all other asset classes. The following are expected of active investment managers over three- and five-year periods²³:
 - i. Exceed their benchmark index *net of fees*.
 - ii. Rank in the top 50% of peer group managers.
 - iii. Maintain a risk level comparable to that of the appropriate benchmark index.
 - iv. **Recommended Update to IPS:** We recommend that the performance standards for active managers be expected to be achieved over a five-year measuring period rather than *both* three- and five-year periods.
- (9) Section 802.109(a)(5)(B)(iii) directs that the report must include “... a detailed review of the... appropriateness of selection and valuation methodologies of alternative and illiquid assets.”

²¹ Parkland Defined Benefit Plan Asset Allocation Review dtd 2/14/2022

²² Milliman Financial Reporting Valuation dtd 11/11/2022, Page 10

²³ Investment Policy Statement dtd 3/31/2021, Page 17

- a. **Alternative Asset Classes:** The Investment Policy Statement expressly prohibits the use of collateralized debt obligations, unregistered equity securities, commodities or commodities contracts, short sales, warrants, margin transactions, leveraged investments, venture capital partnerships or other private equity investments.²⁴ The system has none of these “alternative asset classes” within the portfolio.
 - b. **Private Equity:** During the February 2022 meeting, the Investment Consultant suggested that including a modest allocation in private equity would increase the long-term expected return for the Plan. If this suggestion was adopted, the IPS should be modified to (1) allow for the inclusion of this asset class which is currently expressly excluded and (2) establish multiple key performance indicators for how these managers are to be selected and measured. Particular emphasis should be placed on valuation methodologies, risk expectations and return calculation methodologies.
 - c. **Illiquid Investments:** A modest portion of the total Plan capital – 14.1% – is allocated to illiquid real estate holdings. Liquidation and exit from this investment class is restricted by the available cash in the fund. Given the size of the Plan’s capital in these funds it should be assumed that unfettered access to this capital is NOT available within one quarter.
 - d. **Valuation Methodology for Illiquid Investments:** The two real estate investment managers – Heitman and J.P. Morgan – are the only managers who hold illiquid assets. On an annual basis each firm has the underlying real estate holdings appraised by an independent party.²⁵ These adjustments to value are reflected quarterly as new information becomes available.²⁶ This practice is reasonable and consistent with industry practices for illiquid assets of this type.
- (10) Section 802.109(a)(5)(B)(iv) directs that the report must include “... a detailed review of the... future cash flow and liquidity needs.”
- a. **Cash Flow and Liquidity Needs:** The plan’s anticipated future cash flow and liquidity needs is based on Asset Liability Study conducted by the System’s Actuary. The most recent Asset Liability Study was conducted in August of 2022.²⁷ That study found the 2022 contributions (employer and employee) far

²⁴ Investment Policy Statement dtd 3/31/2021, Page 14

²⁵ Heitman 2021 Annual Report, Page 36; J.P. Morgan Asset Management 2021 Annual Report, Page 34

²⁶ Ibid.

²⁷ Parkland Actuarial Report Executive Summary dtd 2022-7

exceeded the benefit payments (\$62.7m contributions vs. \$38.8m payments and expenses).

- b. **Funding Status:** As of the most recent Asset Liability study, the plan's current funding status is 73.3%.²⁸
- c. Based on these findings the Plan has adopted a funding policy which calls for the following actions to be taken:
 - i. The B&FC has developed a funding policy that includes, but is not limited to, achieving a goal of full funding by 2044.²⁹
 - ii. The B&FC has increased the contributions being made to the Plan in excess of the Actuarial Determined Contribution. Since 2018 more than \$32.0m of "excess contributions" have been made which represents 117.0% of the Actuarial Determined contribution.³⁰
 - iii. The B&FC reduced the return assumptions from 7.0% in 2019 to 6.0% in 2020 and beyond.
- d. **Use of Positive Cash Flows:** The total contributions to the plan – excluding dividends and interest – exceed the projected distributions over the next decade. This "cash flow positive" state is currently used to rebalance the portfolio by purchasing under allocated assets to bring the portfolio back towards its Strategic Allocation. This low need for current liquidity could also be used to rationalize a high allocation to illiquid assets such as Real Estate and/or Private Equity asset classes which – given their lack of liquidity and use of leverage – have higher long term expected returns than other more liquid equity asset classes.
- e. **Liquidity Stress Test:** Each year the Independent Auditor conducts a stress test in which they project the future deficit or surplus if the long-term performance of the Plan is 1.0% lower and 1.0% higher than the current Actuarially Assumed Return.³¹ A decrease of the discount rate from 6.0% to 5.0% results in an increase in the net pension liability to \$670m resulting in a plan that is 70% funded with 30% in unfunded liability. Increasing the discount rate to 7.0% reduced the net pension liabilities to \$150m and would result in a 90% funded

²⁸ Milliman Actuarial Funding Report dtd 1/1/2022, Page 2

²⁹ Milliman Actuarial Expenses Report dtd 11/11/2022, Page 6

³⁰ Independent Auditor's Report and Financial Statement for year ending 12/31/2021, Page 23

³¹ Ibid, Page 20

plan with only 10% in unfunded liabilities. From this study we observe that every increase or decrease in the discount rate results in roughly a 10% increase or decrease in the Plan's funding level.

(11) Section 802.109(a)(5)(C) directs that the report must include "... a detailed review of the... appropriateness of investment fees and commissions paid by the retirement system."

- a. **Fee Policy:** The Investment Policy Statement directs that Investment Consultant will conduct an "Annual review of investment management fees and comparisons with fees of other managers with similar strategies."³² The Callan fee study dated August 2021 found that the cumulative investment management related fees and expenses for the Plan were 0.38% of the plan value. This 0.38% is *below* the peer median of 0.45% for plans of similar size.³³
- b. **Direct Investment Fees:** The December 2021 Annual Report notes that \$3,235,055 was paid in direct investment managed fees. In addition to these fees \$252,674 was paid in custodial fees and \$188,288 in Investment Consulting fees.³⁴ Total direct fees paid by the plan were \$3,676,017 or 0.2298% of the year-end plan value of \$1,599,131,000.³⁵
- c. **Indirect Investment Fees:** The December 2021 Annual Report notes that \$2,392,770 in indirect management fees – fees netted from the return of pooled investments or partnerships – were paid.³⁶ These total indirect fees represent 0.1496% of the 2021 year-end plan value.
- d. **Other Investment Fees:** The December 2021 Annual Report notes that administrative expenses, as distinct from direct and indirect investment expenses, were \$440,000 which is 0.027% of the 2021 year-end plan value.
- e. **Cumulative Fees and Expenses:** The cumulative fees and expense of ~\$6,068,000 represent 0.38% of the 2021 year-end plan value.³⁷

(12) Section 802.109(a)(5)(D) directs that the report must include "... a review of the retirement system's governance processes related to... investment decision-making..."

³² Investment Policy Statement dtd 3/31/2021, Page 5

³³ Callan report on Investment Management Fees dtd 8/31/2021, Page 1

³⁴ Independent Auditor's Report and Financial Statement for year ending 12/31/2021, Page 26

³⁵ Ibid, Page 26

³⁶ Ibid, Page 26

³⁷ Ibid, Page 26

- a. **Governance Structure, Generally:** The Board has adopted a series of investment policies and procedures which are memorialized in the IPS. This document is the sole repository of governance policies unique to the System. Separate and apart from the System’s governance policies the TPRB has adopted several reporting responsibilities for the System which could also be considered “governance policies” but are appropriately not included in the IPS because they are universally applicable to all public funds in Texas.
- b. **B&FC Meetings:** The B&FC allocates a meaningful portion of each quarterly meeting to the oversight, monitoring and direction of the Plan’s capital. Because Board members typically do not have professional experience in strategic and tactical capital deployment, they rely heavily upon the expertise and recommendations of the Investment Committee and Investment Consultant. Ultimately, the Board retains final decision-making authority as to these recommendations.
- c. **Investment Committee Meetings:** The Investment Committee is responsible for providing recommendations and advisory reports to the B&FC. The entire agenda of each quarterly meeting is devoted to investment topics related to the administration of the Plan. The agenda for each of the Investment Committee meetings is designed to fulfill the various governance policies memorialized in the IPS.
- d. **Investment Consultant:** The Board and the Investment Committee are supported by the Investment Consultant with impartial investment advice. The Investment Consultant’s recommendations and reports are informed by the governance policies recorded in the IPS. The incumbent Investment Consultant – Callan – has served the plan since 2013 and is currently engaged through July 31, 2023. Prior to the sunset of the current consulting contract, a competitive RFP for investment consulting services will be issued and candidates, including the current investment consultant, who are interested in being considered for this important role will apply.
- e. **Review of Governance Processes:** It is the long-standing practice of the Investment Committee to conduct an annual review and reaffirmation of the IPS in consort with the Staff and the Investment Consultant. The IPS was most recently reviewed and reaffirmed on March 31, 2021.
 - i. **Recommended Update to IPS:** We recommend that this long-standing practice of annually reviewing and reaffirming the IPS is a sufficiently

important governance discipline that it should be added as an affirmative policy in the IPS.³⁸

- f. **Publicly Available Data:** The IPS for the System, the agenda and minutes from the quarterly meetings of the Investment Committee and B&FC, the current portfolio holdings, actuarial reports, the annual audit report and other work product related to the administration of the plan are available on the System's public website.
 - g. **Management Model:** The System has determined that day-to-day investment management is best done by delegating to external investment managers rather than bringing these responsibilities in-house. This approach is consistent with plans of similar size and, in our experience, is more cost effective than building an internal management infrastructure.
- (13) Section 802.109(a)(5)(D) directs that the report must include "... a review of the retirement system's governance processes related to... delegation of investment authority..."
- a. **Investment Authority:** The IPS is clear that B&FC retains all authority for investment decisions related to the Plan other than (1) the day-to-day investment duties which have been delegated to the various investment managers and (2) the authority to rebalance the portfolio which has been delegated to Staff within clear written guidelines in the IPS. Other than these two exceptions, all investment authority is vested exclusively with the B&FC and has not been delegated.
 - b. **Monitoring Responsibility:** The duty to monitor the risk, return, portfolio allocation, diversification and fees of the Plan have been delegated from the B&FC to the Investment Committee. The Investment Committee, being supported by the Investment Consultant and Staff, reports their findings and recommendations regarding manager performance and asset allocation to the B&FC on a quarterly basis and for other matters on an annual basis.
 - c. **Investment Management:** The day-to-day investment duties, which have been delegated to the various investment managers, have been approved by the B&FC to manage the Plan's capital. As noted in Section 6.e above, there are key performance indicators that the Investment Committee uses to evaluate the efficacy of each of the investment managers. The review of the investment

³⁸ Page 4 of the Investment Policy Statement dtd 3/31/2021 notes that the investment consultant will "Present to the Investment Committee and Parkland staff any recommended changes to this Policy."

managers' performance versus these key performance indicators is conducted perpetually by the Investment Consultant and Plan Staff. The findings from this ongoing measurement are presented to the Investment Committee and the B&FC at each quarterly meeting.

- d. **Rebalance of Excess Cash:** Rebalancing excess cash flow (contributions in excess of distributions) has been delegated by the B&FC to the Treasurer's staff. The terms of this delegation are very narrow and not susceptible to misunderstanding or discretion on the part of Staff. At least once per quarter, an assessment of the Plan's excess unallocated cash is determined by Staff. Based on the approved Strategic Allocation, the Staff identifies which investment managers are most under-allocated, and the excess cash is most often wired to those managers. At each quarterly Investment Committee meeting, Staff reports which rebalances have been made during the prior quarter. The evidence of these monitoring functions is included in the Investment Committee's meeting minutes.
- e. **Governance Review:** Every three years the System engages an independent firm to evaluate and report on the existing policies and procedures adopted by the Plan and evidence whether these policies and procedures have been followed. The independent firm then reports any issues of non-compliance with the existing policies and procedures to the Investment Committee and makes recommendations for any modifications or additions to the existing governance process for the Investment Committee and B&FC to consider adopting. This Independent Policy and Procedures Evaluation was first conducted in 2020 and is again being conducted in 2023.

(14) Section 802.109(a)(5)(D) directs that the report must include "... a review of the retirement system's governance processes related to... board investment expertise and education."

- a. **Board Investment Expertise:** There is no requirement that the members of the Board have any particular investment experience or training as a prerequisite to their participation on the board. The bios of current board members suggests that prior investment expertise is rare beyond participation on this board.³⁹ This lack of direct investment experience is not a governance deficiency, as the Board and its B&FC are supported by the Investment Committee which possesses a deep and comprehensive knowledge of investment matters and by the Investment Consultant retained by the System.

³⁹ <https://www.parklandhealth.org/bios-of-board-members>

- b. **Board Investment Education:** Rule 607.110 of the Texas Administrative Code directs the Minimum Educational Training Requirements for members of the Board.⁴⁰ Specifically, new board members are required to complete the 7-hour core training requirement within their first year of service and will need to complete the 4-hour continuing education requirement every 2 years thereafter. According to Staff’s records, all 11 Board members (as of December 31, 2022) fulfilled their initial 7-hour MET requirement. Further, all 5 Board members who have been serving for a full 3 years have fulfilled their ongoing 4-hour requirement as of year-end 2022. We appreciate that all Board members fulfilled their MET requirements despite the Covid restrictions, which included cancellation of the 2020 TEXPERS Conference at which many trustees receive this educational training.
- c. **Fiduciary and Ethics Policy:** The System has adopted a robust Conflicts of Interest Policy which was most recently affirmed in June of 2022. This policy is designed to identify actual, apparent or potential conflicts of interest. The policy includes a mandatory reporting requirement, a mechanism for third parties to report suspected conflicts, a process for addressing conflicts and an enforcement mechanism if a conflict is found to exist. Besides the System’s internal policy, the educational training required by the TPRB for the board members additionally ensures that they understand their fiduciary responsibilities.
- d. **Board and Committee Selection and Term:** The members of the Board are selected by the County Commissioners. The term of the Board appointment is two years. The Board members select the Board Chair who makes committee appointments including the B&FC. The B&FC recommends and the full board approves the members of the Investment Committee who in turn select their leadership. The term of an Investment Committee appointment is three years with a maximum of three terms.
- (15) Section 802.109(a)(5)(E) directs that the report must include “... a review of the retirement system's investment manager selection and monitoring process.”
- a. **Manager Identification:** If the B&FC identifies the need to search for a new manager – based on a recommendation by the Investment Consultant, Staff and the Investment Committee – the B&FC will direct these parties to conduct a “Manager Search” through a request for proposal process.⁴¹ The Investment

⁴⁰ “Minimum Educational Training Program FAQs – Texas Pension Review Board.” Texas Pension Review Board. <https://www.prb.texas.gov/education-met-program/met-frequently-asked-questions/>. Accessed 6 Mar. 2023.

⁴¹ Investment Policy Statement dtd 3/31/2021, Page 2

Consultant is responsible for identifying candidate managers that meet the criteria identified by the B&FC in the IPS.⁴²

- b. **Manager Selection:** The qualifying criteria for investment manager candidates are, among other factors, (1) a clearly defined investment philosophy, (2) a stable investment team, (3) sufficient assets under management, (4) experience and tenure in managing the strategy, and (4) reasonable fees.⁴³
 - i. **Recommended Update to IPS:** We recommend the Plan adopt a policy that requires the Investment Consultant to disclose any relationship or revenue between themselves and any candidate investment manager that they introduce to the Plan.
 - ii. **Recommended Update to IPS:** We recommend the Plan adopt a policy that at the time of engagement with an investment manager, the manager shall affirm that they act in a fiduciary capacity toward the Plan and its participants.
- c. **Manager Engagement:** The authority to engage a prospective investment manager rests exclusively with the B&FC.⁴⁴ The experience, judgment and recommendations of the Investment Committee, Investment Consultant and Staff inform the B&FC's eventual selection decision. Legal and Finance staff are responsible for reviewing all investment consultant and manager contracts. Outside legal experts are, when needed, also consulted.
- d. **Manager Monitoring:** Once engaged, the actual performance of each investment manager (risk and return outcomes) is compared to (1) a benchmark index that is consistent with the asset class or strategy the investment manager employees and (2) peer group managers within the same asset class or investment strategy.⁴⁵ The Investment Consultant is responsible for calculating and presenting the performance of the overall Fund, the individual investment managers and the key performance indicators used to measure against.
- e. **Performance Reports:** The quarterly performance reports produced by the Investment Consultant are comprehensive and include time series returns (1, 3, 5, 10-year), performance reported as gross of and net of fees⁴⁶, and comparison

⁴² Ibid, Page 7

⁴³ Investment Policy Statement dtd 3/31/2021, Page 7

⁴⁴ Ibid, Page 2

⁴⁵ Ibid, Page 18

⁴⁶ Net of fees returns are available since Callan's inception in 2Q13.

of performance to appropriate benchmark and peer groups. The standardized performance report is well organized and follows an intuitive format that is accessible to trustees with differing levels of investment knowledge and expertise.

- f. ***Manager Watch List***: If concerns develop regarding some aspect of an investment manager's performance or activities, that manager will be put on the "Watch List." That factors that would trigger a manager being included on the Watch List are (1) failure of the manager to meet their performance standards for a sustained period, (2) change in key members of the investment team, (3) change of ownership of the investment management firm, (4) change in focus of the investment manager, (5) judicial or administrative proceedings brought against the manager, (6) violation of an SEC rule has been committed or (7) other factors determined by the Investment Committee.⁴⁷ Because these concerns may or may not be of sufficient importance to justify terminating an investment manager, the Watch List is intended to serve as a management tool for the Investment Consultant and the Investment Committee to evaluate the investment managers.
- (16) Section 802.109(b) directs that "... the governing body of a public retirement system may determine additional specific areas to be evaluated and may select particular asset classes on which to focus."
- a. The System has not identified any additional governance topics or asset classes to be considered as a focus of this report.

⁴⁷ Investment Policy Statement dtd 3/31/2021, Page 8

EXHIBIT A
Document Inventory

1. System Documents
 - a. Investment Policy Statement reaffirmed 2021-03-21
 - b. Individual Manager Guidelines (IPS pp. 18-22)
 - c. Investment Committee Minutes from 2021-12
 - d. Investment Committee Minutes from 2022-02
 - e. Investment Committee Minutes from 2022-06
 - f. Investment Committee Minutes from 2022-08

2. Callan Documents
 - a. Performance Report – 2021-q4
 - b. Performance Report – 2022-q1
 - c. Performance Report – 2022-q2
 - d. Performance Report – 2022-q3
 - e. Asset Allocation and Liability Study – 2022-02-14
 - f. Investment Management Fee Study – 2021-08-31

3. Other Documents
 - a. JPMorgan Annual Report 2021
 - b. Heitman Annual Report 2021
 - c. Actuarial Report – Executive Summary – 2022-08
 - d. Forvis - Defined Benefit Plan Financial Statement for YE 2021
 - e. Milliman Actuarial Expense Report – 2022-11-11
 - f. Milliman Actuarial Funding Report – 2022
 - g. TPRB Guidance for IPPE – 2022-10-06

4. Reports to TPRB
 - a. PRB 100 A & B – 2022-08-02
 - b. PRB 150 – MET – 2022-08-02
 - c. PRB – 200 - 2022-08-02
 - d. PRB – 300 - 2022-08-02
 - e. PRB – 400 - 2022-08-02
 - f. PRB – 1000 - 2022-08-02
 - g. PRB – 2000 Part One and Two - 2022-08-02