Texas Emergency Services Retirement System

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Investment Policy
August 18, 2020

I. Introduction

The Texas Emergency Services Retirement System (System) is a pension trust fund operating under the constitutional and statutory provisions of the State of Texas. A Board of Trustees ("Board") governs the System.

A. The System provides service, disability, death, and survivor benefits for volunteer fire fighters and EMS personnel in departments in the System and for their beneficiaries. Benefits are funded by contributions of the governing entities of participating departments, state contributions, and investment returns.

B. The assets of the pension system are for the exclusive benefit of the members of the System.

C. The assets of the pension system shall be invested and reinvested in accordance with Section 67, Article XVI, Texas Constitution and Title 8 Gov Code, Title H. Sections 865.007 and 865.008.

D. The Texas Emergency Services Retirement Fund ("Fund") is a trust fund established with the comptroller.

II. Purpose

A. The purpose of the Investment Policy is to define policies to guide the implementation of the Board's investment goals and objectives in addition to establishing delegations of authority and responsibility, with the end result being effective management and control of the investment process.

B. This investment policy applies to all financial assets of the System with the exception of cash residing in the state treasury for routine operating expenses and benefit payments.

C. This investment policy is binding upon all persons with authority over the System's assets, including:

1. investment managers/advisors;
2. custodians;
3. consultants;
4. brokers/dealers; and
5. the Executive Director.

D. Board Members, the Executive Director, and System employees shall observe the Ethics Policy, and avoid conflicts of interest and prohibited transactions.

III. Investment Objective

The Board's investment objectives over extended periods of time (generally, ten to twenty years) are to achieve an annualized investment return that equals or exceeds the actuarial investment return assumption of the System. The assumed rate of return as of September 1, 2020 is 7.50 percent.

IV. Investment Strategy

A. It is the policy of the Board to invest funds in a manner that will provide investment return with security while meeting the daily cash flow demands of the System and conforming to all state statutes governing the investment of public funds.

B. The Board may acquire, hold, manage, purchase, sell, assign, trade, transfer, and dispose of any security, evidence of debt, or other investment in which the System's assets may be invested.

C. The objectives of the Board will be implemented based on the following principles:

1. Asset allocation is the most important determinant of investment performance.

2. Reasonable liquidity shall be maintained by the System to meet benefit payment requirements.

3. The investment strategy is long-term, recognizing that the average age of the System's liabilities is relatively long. For this reason, emphasis will be placed upon long-term or strategic decisions rather than tactical or short-term market timing decisions.

4. All major sectors of the capital markets should be considered in order to diversify and minimize total investment program risk.

5. Periodic rebalancing of the allocation of assets among asset classes will be performed to maintain the asset allocation after consultation with the System's investment advisor.

6. The Board of Trustees has delegated to the Investment Committee the responsibility for monitoring the implementation of policies approved by Board and for making appropriate recommendations to the Board.

7. Ongoing due diligence will emphasize investment manager performance over a market cycle, typically a three to five-year period or as otherwise determined by the Board of Trustees.

8. Cost control is valued, particularly regarding investment management fees, and the focus will be on returns net of fees.

9. Economic justification for investment proposals will override social and/or local justifications. Social and/or local investments will only be considered when they provide reasonable and competitive rate of return expectations versus other comparable investments.

10. Formal asset allocation studies will be conducted at least every 5 years, with annual evaluations of the validity of the adopted asset allocation based on updated return projections.

V. Responsibilities of the Board of Trustees

The Board, as fiduciaries of the System, shall:

A. manage the assets for the exclusive benefit of the members of the System;

B. establish prudent investment policies defining investment objectives and strategies;

C. seek to maximize investment return while maintaining the safety of principal;

D. diversify the assets to reduce risk of loss;

E. monitor and document investment performance; and

F. efficiently manage the costs associated with implementation of its investment program.

VI. Responsibilities of the Investment Committee

A. The Board Investment Committee is composed of three board members selected by the Chairman.

B. The Board Investment consultant reports to the Investment Committee.

C. The Investment Committee shall advise the Board and make recommendations on the investment programs of the System and compliance of the investment programs with Board policies.

D. The Investment Committee shall be responsible for preparing and maintaining an Investment Policy for the Board.

E. The Investment Committee shall advise the Board and make recommendations with respect to the appointment of the following service providers:

1. investment managers;
2. transition managers;
3. investment consultants; and
4. custodian banks.

F. The Investment Committee will recommend to the Board specific actions to achieve the investment goals and objectives of the System

G. Duties of the Investment Committee:

1. monitor the System's compliance with the Investment Policy and report to the Board as appropriate;
2. monitor asset allocation to individual asset classes utilized in the investment programs;
3. review the performance of each asset class within the investment programs
4. review investment manager performance;
5. conduct due diligence activities concerning the selection of investment managers and consultants to assure that they are consistent with the policies of the Board;
6. review the net of fee performance of the investment program; and
7. review the performance and independence of the investment consultant.

VII. Responsibilities of the Executive Director

A. The Executive Director is delegated full authority and responsibility by the Board of Trustees in the implementation and administration of its investment programs subject to Board policies, rules, regulations, and directives consistent with constitutional and statutory limitations.

B. Under the authority of the Board of Trustees, the Executive Director will carry out the following duties:

1. Assist the Board in the procurement of investment managers, consultants and

custodians;

2. Authorize guidelines and contracts for each investment manager retained by the System;

3. Recommend to the Investment Committee revisions to the Investment Policy; and

4. Supervise staff in carrying out actions of the Board and Investment Committee.

VIII. Responsibilities of the Investment Consultant

The Board shall use a third party investment consultant working with the Investment Committee to:

A. Act as a fiduciary to the System

B. assist in appraising performance,

C. to provide performance comparison data as requested,

D. assist in evaluating advisor style discipline and peer comparisons,

E. perform manager search and evaluation and perform ongoing manager due diligence,

F. recommend replacement managers and perform fund evaluations as necessary,

G. assist in asset allocation studies, and

H. other duties the Board or Investment Committee deems appropriate.

IX. Responsibilities of the Investment Manager

A. Act as a fiduciary to the System

B. Due Diligence: Each Investment Advisor shall utilize the same due care, skill, prudence and diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity, as a fiduciary, and fully familiar with such matters would use in like activities for like plans with like aims, while maintaining appropriate diversification to avoid the risks of large losses, in accordance and compliance with all applicable laws, rules and regulations from local, state, federal and international political entities as it pertains to fiduciary duties and responsibilities.

C. The duties and responsibilities of each of the registered investment managers retained by the Board include managing the assets under its management in accordance with the policy guidelines and objectives expressed herein in addition to any separate written agreement.

X. Proxy Voting Policy

Voting of proxies shall vest with each manager. Each manager's voting guidelines and procedures shall be submitted to the System.

XI. Asset Allocation

A. The most important component of an investment strategy is the asset mix, or the resource allocation among the various classes of securities available to the System for investment purposes. The Board of Trustees should set long-term asset allocation targets or ranges that will best meet the needs of the plans and their beneficiaries.

B. Within each asset class, the Board of Trustees should adopt implementation strategies and investment styles to meet the overall investment objective of each asset class.

C. The Board should periodically rebalance the asset allocation of the investment portfolios to maintain appropriate diversification.

Target Allocations	Lower Limit	Target	Upper Limit	Benchmark
U.S. Market Equities – Large Cap				
Value	5.0%	10.0%	20.0%	Russell 1000 Value
Growth	5.0%	10.0%	20.0%	Russell 1000 Growth
U.S. Market Equities – Small/Mid Cap				
Value	0%	5.0%	10.0%	Russell 2500 Value
Growth	0%	5.0%	10.0%	Russell 2500 Growth
International Equity – Developed Markets	10.0%	15.0%	20.0%	MSCI EAFE
International Equity – Emerging Markets	0.0%	5.0%	10.0%	MSCI Emerging Markets
Core Fixed Income	15.0%	20.0%	25.0%	Bloomberg Barclays Aggregate
Non-Core Fixed Income^^	0%	10%	15%	Strategy Specific
Cash & Equivalents	0.0%	0.0%	5.0%	
Global Infrastructure^	0.0%	5.0%	10.0%	50% MSCI World/50% Bloomberg Barclays Aggregate
US Core Real Estate*	0.0%	10.0%	15.0%	NCREIF ODCE Equal Weighted
Multi Asset Investments	0.0%	5.0%	10.0%	50% MSCI World/50% Bloomberg Barclays Aggregate

*The unallocated or uncalled portion of the target allocation to Real Estate will be allocated to Core Fixed Income.

^The unallocated or uncalled portion of the target allocation to Infrastructure will be allocated to Multi Asset Investments

^^ The unallocated or uncalled portion of the target allocation to Non-Core fixed income will be allocated to Core fixed income

XII. Investment Performance Benchmarks

A. Total Portfolio Performance

1. To earn an average rate of return over the long term (3 to 5 years) which exceeds the return of a Target Index. The Target Index for the Plan is defined in the TARGET ALLOCATIONS

table.

2. On a relative basis, it is expected the total portfolio performance will rank in the top 50th percentile of the appropriate peer universe over three- and five-year time periods.

B. Investment Manager Performance

1. The specific investment objectives for each investment manager will be outlined in addenda to this overall Statement of Investment Policy.

2. On a timely basis, but not less than four times a year, the Board will review actual investment results achieved by each manager (with a perspective toward a five-year time horizon) to establish manager adherence with performance guidelines established herein.

3. The Board wishes to adopt standards by which judgments of the ongoing performance of a portfolio manager may be made. If, at any time, any three of the following are breached, the portfolio manager may be warned of the Board's serious concern for the Plan's continued safety and performance. If any five of these are violated, the consultant may recommend a manager search for that mandate.

a) Four (4) consecutive quarters of relative under-performance verses the benchmark.

b) Three (3) year trailing return below the top 50th percentile within the appropriate peer group and under performance verses the benchmark.

c) Five (5) year trailing return below the top 50th percentile and under performance verses the benchmark.

d) Three (3) year downside volatility greater than the index (greater than 100), as measured by down market capture ratio.

e) Five (5) year downside volatility greater than the index (greater than 100), as measured by down market capture ratio.

f) Style consistency or purity drift from the mandate.

g) Management turnover in portfolio team or senior management.

h) Investment process change, including varying the index or benchmark.

i) Failure to adhere to the IPS or other compliance issues.

j) Investigation of the firm by the Securities and Exchange Commission (SEC).

k) Significant asset flows into or out of the company.

l) Merger or sale of firm.

m) Fee increases outside of the competitive range.

n) Servicing issues – key personnel stop servicing the account without proper notification.

o) Failure to attain a majority vote of confidence by the Board.

4. Nothing in this section shall limit or diminish the Board’s right to terminate the manager

at any time for any reason.

XIII. Allowable Investments

Unless otherwise specifically stated by the Trustees in an official document separate from this policy, each investment manager may invest and reinvest the assets in a diversified portfolio of fully negotiable, US dollar denominated fixed income, equity and money market securities provided they meet the following criteria:

A. Equity Securities

1. Investment in all equity securities shall be limited to those actively traded on a national exchange or network; and

2. Not more than five percent (5%) of the System's assets, at the time of purchase, shall be invested in the common stock, capital stock or convertible stock of any one issuing company, nor shall the aggregate investment in any one issuing company exceed five percent (5%) of the outstanding capital stock of the company; and

3. Additional criteria may be outlined in the manager's addendum

4. Pooled vehicles as defined under the Pooled Investment Funds section of the policy.

B. Fixed Income Securities

1. Direct fixed income investments at purchase must have a minimum rating of investment grade as reported by a major credit rating service. In the case of split ratings, fixed income securities are permissible when rated investment grade or higher by at least one major rating agency. Fixed income securities, which are downgraded below the minimum rating by the rating agency used to justify the purchase, shall be sold at the earliest beneficial opportunity.

2. The value of bonds issued by any single corporation shall not exceed five percent (5%) of the total fund; and

3. Additional criteria may be outlined in the manager's addendum

4. Pooled vehicles as defined under the Pooled Investment Funds section of the policy.

C. Real Estate

1. Investments in real estate shall not exceed 15% of the market value of the total Plan assets at the time of purchase.

2. The Plan will seek to diversify its real estate investments by property type (multi-family residential, industrial, office, retail, timberland, etc.) and property location (geographic region).

3. Real estate investments are intended to provide a high level of income, low volatility of total return, and a low correlation to other asset classes.

4. All real estate investments shall be managed by experienced and qualified professional real property investment managers.

D. Pooled Investment Funds: Investments made by the Trustees may include pooled funds. For purposes of this policy pooled funds may include mutual funds, commingled funds, and exchange-traded funds.

1. Such funds may be governed by separate policy which may include investments not expressly permitted in this Investment Policy Statement. In the event of investment by the Trustees into a fund the Plan will adopt the prospectus of that fund as the stated addendum to this Investment Policy Statement.

2. The asset classification of the fund will be based upon its investment objective.

3. All pooled funds should have investment objectives that are consistent with the Plan's to qualify for investment by the Plan.

E. Use of Derivatives:

1. Derivatives may be used for the purpose of reducing or controlling risk, reducing transaction costs or shifting an asset mix.

2. Prior to the use of specific derivative methodologies, the Investment Manager will seek approval of the Board. The Investment Manager must identify the purpose of the derivative exposure. The Investment Manager must demonstrate the expertise, strategy and internal controls to effectively manage the derivative positions. If the Investment Manager cannot explain the use and purpose of derivatives to be used in lay terms, derivatives may not be used in the System's portfolio.

3. Investment Managers using derivatives will have a written policy in place and the capability to readily report on the derivative instruments and exposures. In the Investment Manager's quarterly report, or more frequently as requested by the Board, the Investment Manager will outline the derivative(s) used currently in the portfolio and include a statement identifying that the Investment Manager is in compliance with the Investment Policy Statement.

XIV. PROHIBITED INVESTMENTS

Unless otherwise specifically approved by the Trustees, the following investments and/or transactions are prohibited: use of derivatives, short sales or margin purchases of securities, the use of commodities, private placements or restricted securities, investments in interest only or principal only CMOs, interest rate swaps, precious metals, limited partnerships of any kind, venture capital, futures contracts or options contracts.

XV. Evaluation and Due Diligence Process for Closed End Funds

In the development of a diversified investment portfolio of Closed End Funds within the System's overall target allocation, it is the intent of the Board, pursuant to recommendations made by the Investment Committee, to implement this portion of the portfolio through the recommendation of various investment offerings that are typically structured as illiquid interests in Closed End Funds.

The Investment Committee's due diligence process and ultimate fund selection criteria considers a variety of attributes of individual managers. This enables the Investment Committee to recommend funds that show the greatest potential for superior future financial returns. Although the following criteria may not apply to all Closed End Fund opportunities, the items listed do outline the qualities and attributes to be sought in identifying appropriate Closed End Funds for the Board's consideration.

A. People/ Organization – Stable, established organization with a committed team that has successfully worked together for a significant period of time, indicating high compatibility and low organizational risk. Key areas of focus include:

1. Assets under management;
2. Industry presence/tenure;
3. Significant general partner, manager or similar position commitment to the fund;
4. Significant and relevant experience of senior professionals;
5. Low turnover rates and significant tenures; and
6. Alignment of interests, including:
    a) Reasonable distribution of ownership among senior professionals;
    b) Reasonable compensation, including the sharing of carried interest;
    c) Regular performance reviews;
    d) Sufficient staffing to support the attention and needs of the portfolio;
    e) Good "bench strength" and a business that is not overly reliant on any single person; and
    f) With respect to "next generation" funds, a history of the principals working together as a team and a clear attribution of prior success to that team.

B. Operational Expertise – Operational expertise, either internal or through some proprietary relationship, especially that gained through prior difficult market cycles or leveraged situations specific to the Closed End Fund’s underlying strategy. Exceptional returns are driven by post-acquisition operational improvements and not so much by financial engineering. In addition, operational expertise can be crucial in attracting deals and facilitating transactions.

C. Independence – Preference is given to truly independent managers because of the lower tendency for conflicts of interests, widely variable investment focus, and potential misalignment of interests among the principals. In general, situations to be avoided include:

1. Funds sponsored by investment banks or large financial institutions engaged in other activities focused on investment or financing businesses.
2. Firms with large or controlling interests.

D. Investment Strategy/Philosophy – A clearly defined and articulated strategy that is supported by the experience of the manager's professionals and consistently applied. Preference is given to firms whose funds are appropriately sized for the stated strategy since they are better able to deliver the type of return required from this potentially illiquid asset class.

E. Track Record – Manager track records are examined as an indicator of their ability to add value to companies in which they invest. However, it is often difficult to evaluate managers on fund returns alone, because data is often immature. As such, considerable emphasis is placed on qualitative factors (i.e., adherence to strategy; team dynamics; etc.). It is important that the track record provide evidence that the strategy employed has been successful and will likely remain so in the future. The track record information will be reviewed in the following manner:

1. Historical rates of return – Internal Rates of Return (IRR) are calculated on a consistent

basis in order to assure accuracy and some degree of comparability between managers. Returns are analyzed in a variety of ways: absolute and relative to benchmarks; realized and unrealized; returns of attributable to current principals; returns attributable to deals following the current strategy, etc. In addition to IRR, cash-on-cash returns are also considered.

2. Historical quality of returns – The quality and consistency of returns are as important as the absolute level of returns. Therefore, examination will be conducted of the concentration of returns and the timing of capital deployment and exits. The manager's rate of deploying capital in past funds is analyzed against the size of the new fund and any difference between past and prevailing market conditions, which may affect future deployment.

3. Record of realizations – A record of realizations from past investments shall be reviewed. This provides a valuable measurement of returns; it indicates a manager's ability to properly manage exists; and it lessens the time required by the manager to manage past funds' investments (where such activity would dilute their attention to the new fund).

4. Financing Experience – Managers with solid reputations in the leveraged finance markets, proven ability to access debt and other capital, and a demonstrated ability to manage through difficult periods in the capital markets cycle. A manager's history of dealing with problem investments, loan workouts, and restructurings will be addressed.

5. Deal Flow/Research – Managers with proprietary sources of deal flow and, therefore, the ability to make acquisitions at reasonable multiples. In addition, preference will be given to firms that perform target-market research to help focus investment activity and deal sourcing.

6. Decision Making – Defined processes and shared decision-making. A concentration of decision-making power is not desirable. A diversity of backgrounds and experience within a firm may add to the quality of decision-making.

7. Investor Base – Managers that have a significant number of returning institutional investors. It can be a warning sign when investors opt not to return or reduce their commitments to subsequent funds. The quality and diversity of the investor base is also considered.

8. Terms – Investments will have suitable financial terms (management fees, carried interest, claw back, key man, etc.) and governance provisions, which will be properly reflected in the underlying governing documents.

XVI. Investment Policy History

Date	Action	Comments
August 29, 2007	Board adopted new asset allocation	Added international fixed bonds as an asset class and adjusted target allocations accordingly.
August 26, 2009	Board recommended update to performance benchmarks	Eliminated Section XII. “Performance Benchmarks For Asset Classes” column, “Percentile Expectation Relative to other managers” and related information in the paragraph B.1. Also updated Lehman Brothers Index to Barclays Capital Global Aggregate Bond and Barclays Capital US Aggregate Bond Index.
December 10, 2009	Board adopted new Investment Policy as recommended August 26, 2009.	
August 31, 2010	Board adopted updated Investment Policy	Changed Section III. Investment Objective actuarial rate of interest from 8.0 to 7.75%. Also changed Section XII Performance Benchmarks from 40th to 50th percentile expectation relative to style peers and adjusted Total Fixed Income Annualized return relative to Index. Added language to A.2. and B. in the same section to reflect the change.
August 31, 2011	Board adopted new asset allocation	Added International Equity – Emerging Markets as an asset class and adjusted target allocations accordingly.
December 2013	Board adopted Master Limited Partnerships as a new asset class with an allocation of 5%	
June 2014	Board presented with an updated Investment Policy for approval	References to ‘Commissioner’ and ‘Firefighter Pension Commission’ were changed; reference to the Ethics Policy adopted in April 2014 was added; and, the asset allocation method was adjusted per the addition of an MLP asset class.
June 2015	Board presented with an updated Investment Policy for approval	Use of the word ‘Core’ was dropped from the description of US Market Equities, after the words ‘Large Cap’ and ‘Small Cap’ on Page 4. The asset class name for ‘Core Bond’ was changed to ‘Domestic Fixed Income’ on Page 4.
June 2016	Board Revised Asset Allocation	Removed International Bonds as an asset class and increased allocation to Domestic Fixed Income.
May 2017	Board adopted updated investment policy language and revised	Updated language on manager performance measurement, allowable investments, and the use of derivatives. Asset allocation replaced the use of small growth and value

Date	Action	Comments
	asset allocation	with small/mid growth and value. Core real estate was introduced.
August 2017	Board revised asset allocation	Asset allocation was amended to reflect the use of core real estate
August 2018	Board revised asset allocation	Asset allocation was amended to reflect the use of multi-asset class fund investments
March 2020	Board revised asset allocation and Other Changes	The changes included in the allocation table reflect the discussions and findings from the asset liability study which AndCo presented in Q4 2019. The tangible changes: • Addition of Infrastructure to replace MLPs at 5% target • Addition of Non-Core fixed income at 10% target • Increase in target to Core Real Estate to 10% • Reduction in US Large Cap from 30% to 20% • Reduction in small/mid equity from 15% to 10% Also: Expanded the responsibilities of the investment consultant to include manager searches. Removed Real Estate from the list of prohibited investments
August 2020	Board adoption of a 7.50% investment return assumption and clarification that the investment consultant serves as a fiduciary	