County Employees Retirement System
Board of Trustees – Trustee Education Session
July 17, 2024, at 2:00 pm ET (1:00 pm CT)
Live Video Conference/Facebook Live

AGENDA

1.	**Call to Order**	**Lisle Cheatham**
2.	**Opening Statement**	**Eric Branco**
3.	**Roll Call**	**Sherry Rankin**
4.	**Public Comment**	**Sherry Rankin**
5.	**Chairman's Corner**	**Lisle Cheatham**
6.	**Trustee Training -- Governance**	**David Lindberg** **Craig Morton** **Chris Tessman**
7.	**Trustee Recognition**	**Lisle Cheatham**
8.	**Adjourn**	**Lisle Cheatham**

***Board May Take Action**


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CERS – Trustee Training Session
July 17, 2024
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The Importance of Good Governance

Best Governance Practices for Public Retirement Systems (NCPERS, Updated February 2024)

- There is a link between implementing strong governance practices and improved long-term performance
- Governance covers more than just investments, especially in today's world of increased complexity and reliance on technology
- Managing reputational risk is an ongoing challenge for public pensions, especially in an age where some investment decisions are becoming politicized
- In addition to having strong practices, it is critical to communicate clearly to stakeholders

https://www.ncpers.org/files/resources/NCPERS_BEST%20GOVERNANCE%20PRACTICES_Final_2024.pdf

All Eyes on Public Pension Funds… Again

Fund governance became a hot topic after the GFC exposed some funds for being much riskier than previously assumed.

There is increased focus on public fund governance after the volatility of COVID, rising rates, and elevated inflation.

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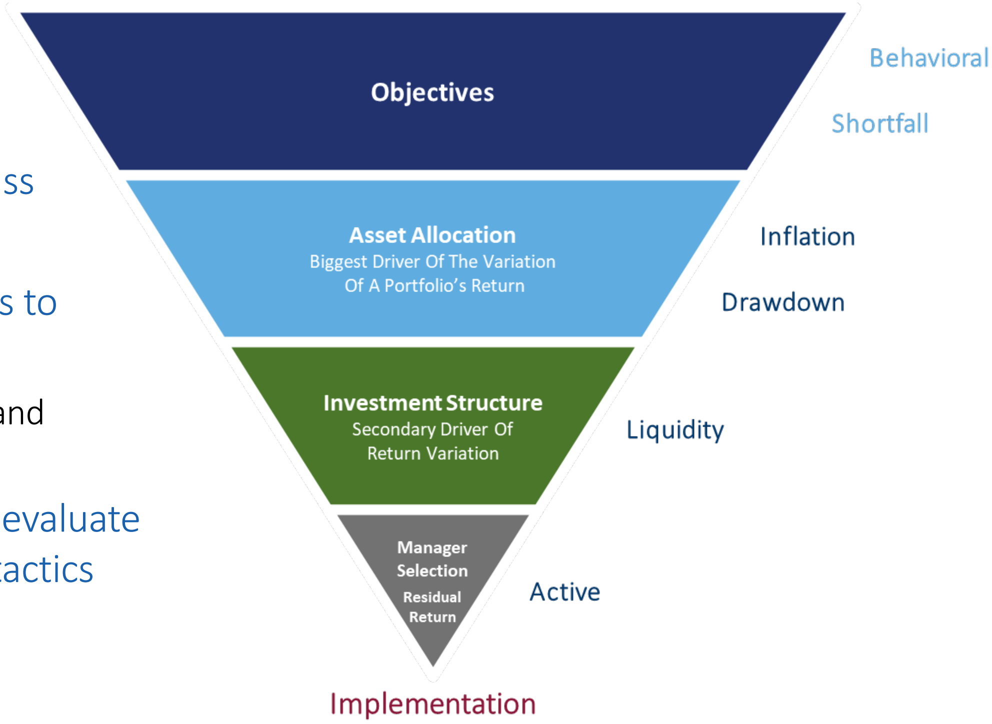
Investment Decision Making Framework

- Establish investment philosophy
- Establish appropriate asset allocation policy
- Determine investment objectives for each asset class
  - Target value-add, active risk level
- Select appropriate investment strategies and tactics to achieve investment objectives
  - Asset class benchmarks, structures for asset classes, and implementation activities
- Establish monitoring and evaluation procedures to evaluate the success of investment program strategies and tactics
- Risk management should play a role in each step



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Risk Assessment Framework

Wilshire's multi-dimensional view of risk integrates organizational and investment considerations into a comprehensive framework for evaluating strategic decisions.

- Shortfall: Support distributions and long-term growth
- Behavioral: Instill strong governance
- Drawdown: Limit portfolio losses
- Inflation: Preserve long-term purchasing power
- Liquidity: Balance near-term needs, long-term opportunities
- Active: Ensure unique exposures
- Emerging & Long-Term: Environmental, Social & Governance risks, such as externalities, intangibles and reputation may be linked to various risk lenses

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Wilshire Fundamental Risk Beliefs

Understanding Risk Drives the Investment Process

- Risk should be compensated: Risk and return go hand-in-hand, but not all risks are rewarded equally. Be extremely selective.
- Downside and behavioral risks should be managed: Investors are enamored with potential returns and often underestimate the associated risks. Drawdowns destroy long-term wealth potential. Actively manage risk exposures.
- Market timing can be dangerous: "Tactical" investments may create more risk than return...use tactical positioning only when the potential reward is compelling.
- Costs matter: In a world of uncertain outcomes, fees and expenses are risks that are known with near-perfect insight and are a hurdle between the portfolio and its objectives. Be an extremely disciplined buyer and implement active management in-line with one’s philosophical beliefs on market efficiency.

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Rules for Institutional Investors

- Focus on decisions that matter
- Time horizon is key to the asset mix choice
- Control risk through diversification
- Have an investment policy and stick to it
- Focus on the “big picture” when monitoring investment performance
- Past performance can be a misleading indicator of future performance
- Market timing doesn’t work
- Pay attention to management fees and other expenses

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“The fiduciary buck stops with the Board”

Best Governance Practices for Investment Committees (CFA Institute, Greenwich Roundtable, 2014)

Responsibilities of the Board

The Board has the ultimate responsibility for what the organization does, including investments:

- Establish a framework, codified in the IPS and other policy documents
- Establish and appoint an Investment Committee
- Delineate responsibilities and authority
  - Strike a balance between staying high-level by delegating authority, and keeping approval power for key decisions
- Establish oversight framework
  - Timing and contents of reporting and updates

https://www.cfainstitute.org/-/media/documents/support/advocacy/gr-bp-governance.ashx

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Investment Policy Statement (IPS)

- Articulate investment philosophy and long-term investment objectives
- Delineate duties and responsibilities of Board, key subcommittees, investment staff, and other professional advisors
- Codify asset allocation policy and implementation plan
- Specify when to rebalance
- Establish procedures for investment services selection and performance monitoring
- Establish risk tolerances
- Act as a document of continuity in the case of Board and staff turnover
- Avoid frequent changes to policy in both design and action

Navigating Choppy Waters, Charting the Appropriate Course

An Investment Policy is a customized, living document tailored to the unique considerations of each institution

As needs evolve over time, iterative adjustments help maintain course towards stated goals

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What/Who is a Fiduciary?

- Derived from the Latin term for "Trust"
- A fiduciary is a person or organization that acts on behalf of another person or organization and is legally and ethically bound to act in their best interests. This means that a fiduciary must put their client's interests ahead of their own and have a duty to preserve good faith and trust
- Any person who:
  - Exercises any discretionary authority or control over the management of a pension plan, or over the management or disposition of plan assets (i.e. Board, IC, staff, managers, consultants)
  - Provides investment advice for a fee or other compensation (i.e. managers, consultants)
  - Has any discretionary authority or discretionary responsibility in the administration of a pension plan (i.e. staff, discretionary advisors)

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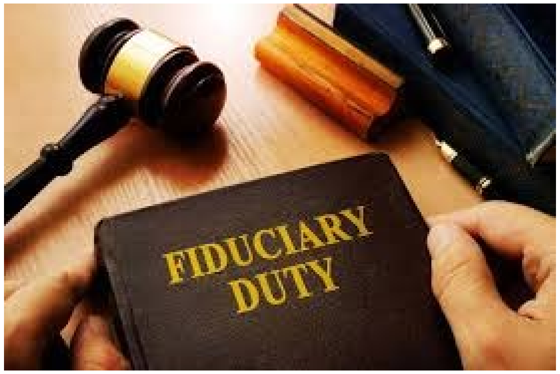
Fiduciary Responsibilities

- Fiduciaries have a "Duty of Loyalty"
  - A fiduciary shall discharge his or her duties with respect to a pension plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries*
- Prudent Person Rule
  - A fiduciary must act “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims.
- Duty to Monitor
  - The fiduciary is under a continuing duty to monitor the service provider and their investment results
- Duty of Disclosure
  - The core of a fiduciary’s responsibility is the duty to disclose material information, which may even include possible changes to the plan that are under "serious consideration"



*Source: Employee Retirement Income Security Act of1974, Section 404(a)(1)

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Prudent Person Standard for Investments: Portfolio Theory

- Appropriate Consideration
  - Asset Allocation / Diversification
  - Liquidity / Cash Flow
  - Projected portfolio return relative to funding objectives
- Prudent Procedures
  - Fiduciary duties focus on the procedures that are followed, *not* the outcome of their actions
  - Procedures include conducting a thorough analysis before acting and consulting with experts before engaging in complex or unfamiliar transactions
  - Fiduciaries have an affirmative duty to seek the advice and counsel of independent experts when his / her own ability is insufficient under the circumstances

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Benchmarking

- Using appropriate benchmarks is critical to evaluate the performance of the portfolio – managers, composites, positioning, and the total fund
  - Public market investments are typically straightforward to benchmark using widely available benchmarks
  - Private markets are best evaluated using dollar-weighted returns (while the typical performance report is time-weighted) such as IRR, or multiples like TVPI
    - PME (Public Market Equivalent) benchmarking uses the cash flows from a private asset class and the returns from a similar public asset class. For example, a private equity portfolio might be compared to the return that the same cash flows would have produced if invested in the FT Wilshire 5000 Index
    - Using lagged public market benchmarks for time-weighted evaluation of private asset classes is a reasonable option for regular performance reporting, as long as the shortcomings of the approach are understood
- It is important to understand the monthly/quarterly performance drivers and results, but the focus of the Board should always be on the long-term objectives

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Upcoming IPS Discussion

- Clear delineation of roles and responsibilities
  - The Board should determine the division of responsibility and authority that allows it to exercise sufficient oversight while remaining focused on the most high-level decisions
    - What is delegated to the IC, or to staff, and what the approval and/or reporting process should look like when changes are made
- Formally defined procedures and documentation
  - The IPS and associated policies spell out the appropriate process for various activities and decisions
    - Internally managed asset and proxy accounts could use more detailed language in the IPS
- Lines of communication
  - Clear and timely communication between various stakeholders facilitates strong decision making and controls
    - Where responsibility is delegated, there should be a feedback loop to allow the Board to stay informed

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Important Information

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