

FIRE & POLICE PENSION ASSOCIATION of COLORADO



# To Delegate or Not Delegate Investment Decision Making

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**FPPA**

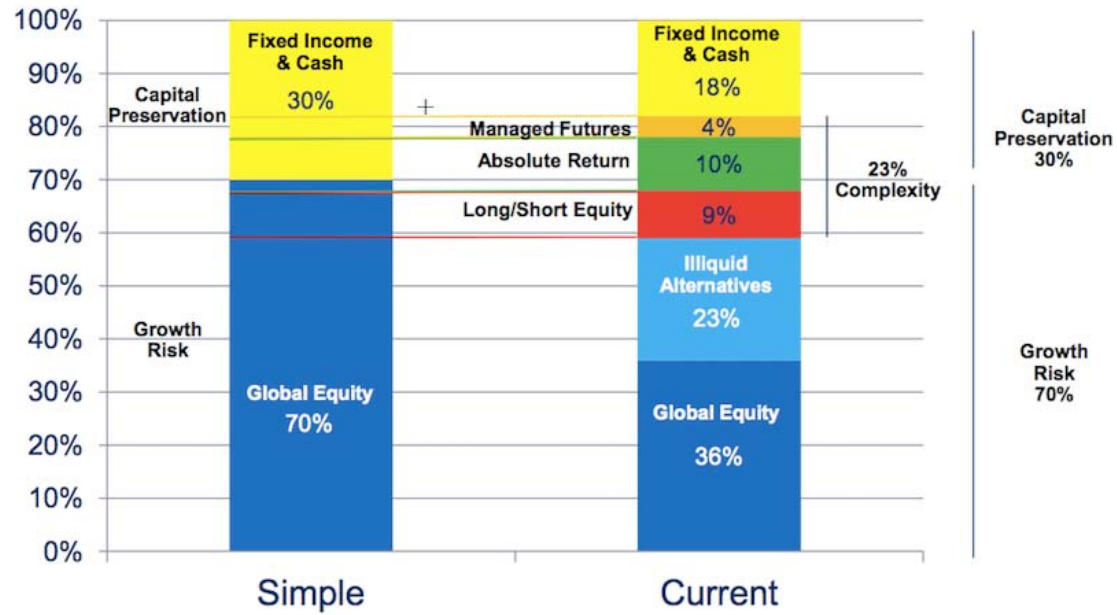
# Fire & Police Pension Association of Colorado

- Provide retirement and death and disability benefits to municipal police and fire
- Not a monopoly
  - Provide retirement benefits for about 75% of departments in state
  - Provide disability benefits for about 95% of departments in state

# Fire & Police Pension Association of Colorado

- About 10,000 in our statewide retirement plans; 5,000 retirees
- About 12,000 in our disability plan
- Defined benefit assets of approx. \$5 billion
- Defined contribution and deferred compensation assets of approx. \$500 million

# Asset allocation



## Full delegation model

- Effective January 2017
- Internal (staff) Investment Committee created to vet deal flow (manager hires/fires)
- Investment Committee meets quarterly to discuss larger issues—portfolio construction; asset allocation; etc.

# Basic Fiduciary Obligations

- What is a fiduciary?
  - A person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor
  - One who must exercise a high standard of care in managing another's money or property
  - Assets of the Plan are those of the participants and beneficiaries – not the State

# Fiduciary Obligations

- Statutory or Common Law – similar themes
  - Invest and manage assets as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances.
  - Exercise reasonable care, skill, and caution.
    - Determined in light of the facts and circumstances existing at the time of a trustee’s decision or action – not by hindsight.
    - Obligations may be modified by the plan document.
  - Evaluated not in isolation but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk return objectives reasonably suited to the trust.

# Fiduciary considerations

- General economic conditions
- Effect of inflation or deflation
- Tax consequences
- The role that each investment or course of action plays within the overall portfolio
- Expected total return
- Needs for liquidity and preservation and appreciation of capital



# Fiduciaries:

- must make reasonable effort to **verify facts** relevant to the investment and management of trust assets.
- may invest in any kind of property or type of investment consistent with the standards.
- shall **diversify** the investments unless trustee determines that the purposes of the trust are better served without diversifying.
- shall invest and manage the trust assets **solely in the interest of the beneficiaries**. – Duty of Loyalty
  - Settlor functions vs. fiduciary functions
  - Wearing “two hats”
- shall **act impartially** in investing and managing the trust assets.

# Fiduciary Obligations – Bottom Line

- Duty of Prudence
- Duty of Loyalty

## Delegation by a Fiduciary

- A trustee may delegate investments and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. Shall exercise reasonable care, skill and caution in:
  - Selecting an agent.
  - Establishing scope and terms of delegation.
  - Periodic monitoring and review of agent's actions.
  - Proper delegation limits trustees liability for actions of agent.

# Delegated Fiduciary

- Agent owes a duty of reasonable care
  - Agent by accepting delegation of fiduciary obligations submits to the law and the jurisdiction of the state of the pension fund.
- To what standard or care are you holding your agents?

# Relationship to Federal Law

- The Internal Revenue Code
  - State funds are tax exempt entities under Section 501(a) of the Code and are subject to the Code’s “Exclusive Benefit Rule” under Section 401(a) and “Prohibited Transaction Rules” under Section 503(b)
  - IRS is responsible for interpretations and monitoring compliance
- Employee Retirement Income Security Act
  - state plans are not subject to ERISA, but many public pension plans generally attempt to comply with ERISA
  - U.S. Department of Labor is responsible for interpretations and monitoring compliance

# Federal Law

- Exclusive Benefit Rule

- Section 401(a) of the Code and Section 404 of ERISA provide that a plan must be maintained and the fiduciaries must act for the exclusive purpose of providing plan benefits to participants and beneficiaries

- Prudence

- ERISA has a prudent expert standard which should generally be followed except upon the advice of counsel

- Diversification

- To minimize the risk of large losses

# Federal Law

- Prohibited Transactions and Exemptions
  - No self-dealing
  - Cannot act in transaction on behalf of anyone whose interests are adverse to the plan
  - Certain transactions outright prohibited
  - Restrictions on investments with the State or contributing employers to the plan

# Selecting and Monitoring Investments

- Documentation of Process is Key
  - A fiduciary is not judged by the results of decisions, but rather by the process undertaken to reach such decisions



# Fiduciary Delegation

- Delegations of Authority
  - When a fiduciary delegates authority, the fiduciary has, at a minimum, an obligation to select the delegate prudently, provide the delegate with the resources or information necessary to carry out the functions, and actively monitor the appointment.

# Outside Investment Managers

- Duties Imposed upon Outside Investment Managers
  - Not clear fiduciary rules apply to third parties by statute
    - Address this in contract provisions.
  - Fiduciary obligations are contractual in nature
  - However, the duty of loyalty provisions apply to employees and consultants of the plan when acting on behalf of the plan

# FPPA Investment Authority

- Pre-2010, the full Board undertook most investment implementation functions
  - Manager Hires: upon the completion of lengthy RFP process, 3 firms typically interviewed before a Board hire
  - Manager Monitoring: rigid watch-list criteria required frequent manager presentations to the Board
  - All manager terminations required Board approval
  - Significant reliance upon consultants and fund-of-funds

# FPPA Investment Authority

## Pre-2010

- General Investment Consultant was the primary driver of investment recommendations and information used by the Board
- Specialty consultants and fund-of-funds used in a “discretionary” model for private equity, real estate, hedge funds
- No Board committees

# FPPA Investment Authority Pre-2010

- Investment Staff
  - Staff of 3 investment officers, plus one back-office
  - Responsibilities focused on monitoring and reporting
  - Significant reliance on consultants and fund-of-funds
  - New CIO hired 2009 with increased investment skills

# FPPA Investment Authority 2010—2013

- Investment Committee created
  - Assist the Board in implementing and monitoring the investment portfolio
  - Concur that investment recommendations comply with policy
  - Met 25-30 times per year; usually by conference call
  - Deal flow approval

# FPPA Investment Authority 2010—2013

- Significant increase in investment staff
- The Board delegated additional authority to staff
  - Manager hires: for alternative investments with a total commitment of <2% of fund assets, staff can hire with approval of Investment Committee and memo from consultant noting adequate diligence and compliance with policy
  - Manager terminations: same process as manager hires
  - Staff was delegated responsibility to monitor managers

# Role of Investment Consultant

- Post-2010
  - General consultant continued in the Board consultant role – “eyes and ears”
    - Participates in Investment Committee and Board meetings
    - Provides concurrence opinions on alternative investments (along with a specialty firm for hedge funds)
  - Manager responsibilities and asset/liability studies delegated to staff



# FPPA Investment Authority 2014-2016

- Post-2013 Investment Committee structure
  - 3-4 voting Board members
  - 2 non-voting staff members (Executive Director & General Counsel) (initially were voting members)
- Role evolved from process review to include substantive review
- Review of all investment recommendations (not just the <2% deals)

# FPPA Investment Authority Current Framework

- Board – sets policy, establishes risk tolerance and strategic allocation. Monitors investment program implementation.
- Investment Committee – provides advice to the investment staff and assists the Board in monitoring investment program implementation (eyes and ears of the Board).

# Current Framework

- Internal Investment Committee
  - Executive Director, General Counsel/Deputy Executive Director, Risk Officer, Head of “other” portfolio
  - Responsible for deal flow vetting and approval
  - Meets as needed; involved from the early stages of diligence

# Current Framework

- Board Consultant – frame strategic level decisions for Board decision making. Educate, report, benchmark, advise.
- Investment Staff – implement investment policy. CIO makes investment decisions within delegated authority.
  - Advise on investment policy
  - Implement portfolio construction and manager selection
- Investment Consultant – provides non-discretionary advice to the Investment Staff

# Questions? And Answers.