

# (Re)Educating Governing Body Members to Understand Their Role in Investments

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MARCH 8, 2022

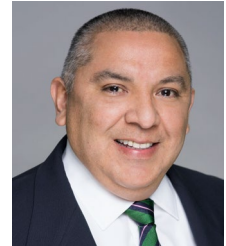


# Who We Are:

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**Tito P. Villegas, Jr., CPA, CFA**

Chief Financial Officer & Chief Investment Officer  
Texas Municipal League Intergovernmental Risk Pool



**Dan Smereck**

Managing Director & Principal  
Strategic Asset Alliance



# What Are a Trustee's Investment Responsibilities?

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# What Are a Trustee's Investment Responsibilities?

Trustees carry numerous duties as part of their overall responsibilities for the pool's investment operations:

1. To act with 'reasonable' skill and care;

Dependent upon the trustee's personal knowledge.

2. To take advice where appropriate;

If not fluent with investments, trustees should get proper education (at a minimum) and/or advice unless the cost of advice is prohibitive relative to the size of the risk pool.

3. To keep investments under review;

Investments should be reviewed regularly by trustees in conjunction with appointed advisors, as applicable.

## Investment Responsibilities (Continued)

Trustees must also include these key elements into their decision-making process as it relates to their investment responsibilities:

1. Suitability;

i.e. member needs, appropriate asset classes, etc.

2. Diversification;

Reducing the overall risk profile of the pool.

3. Delegation, not abdication, of investment management functions;

i.e. periodically reviewing internal/external investment policy statements and/or monitoring how the manager is adhering to the policy.

## Investment Process is Key

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**Additionally, Trustees must understand their risk pool's investment process in order to correctly apply these elements and fulfill their responsibilities.**

# What is a Risk Pool's Investment Process?



For government risk pools to achieve strong investment results, a similarly strong investment process is required.

The investment process goes beyond choosing the right investment manager and consists of these six components.

# Key Errors Trustees Should Avoid

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## Typical Errors

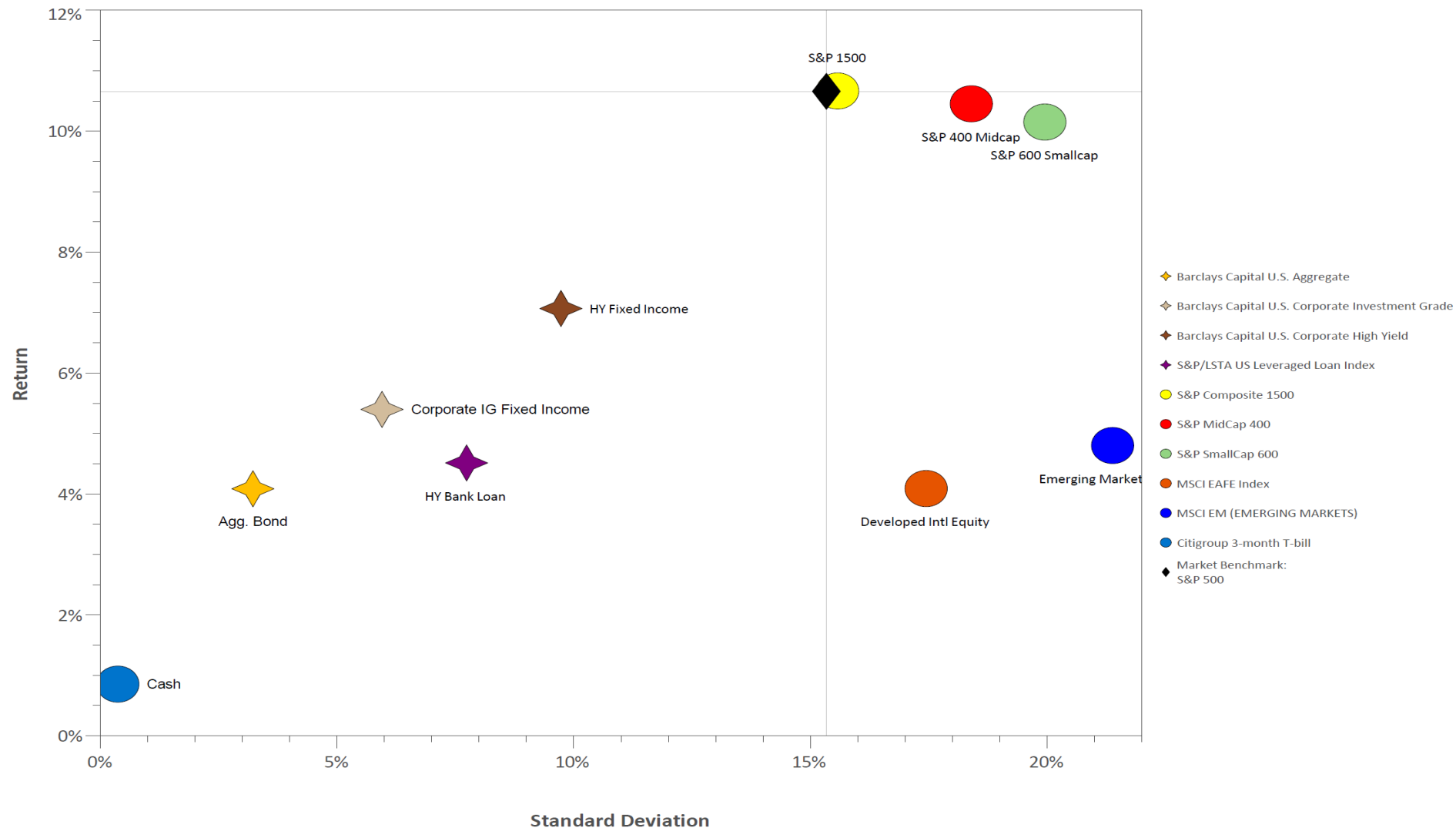
Trustees are often unaware of decisions that could have provided improvement, but are never shown on financial statements:

1. Not considering all allowable asset / a more diversified portfolio;
2. Not reviewing the pool's overall investment process on a periodic basis;
3. Not consistently reviewing investment manager;

# Asset Class Risk & Reward – Latest 15 Years

## Risk / Return - Latest 15 Years

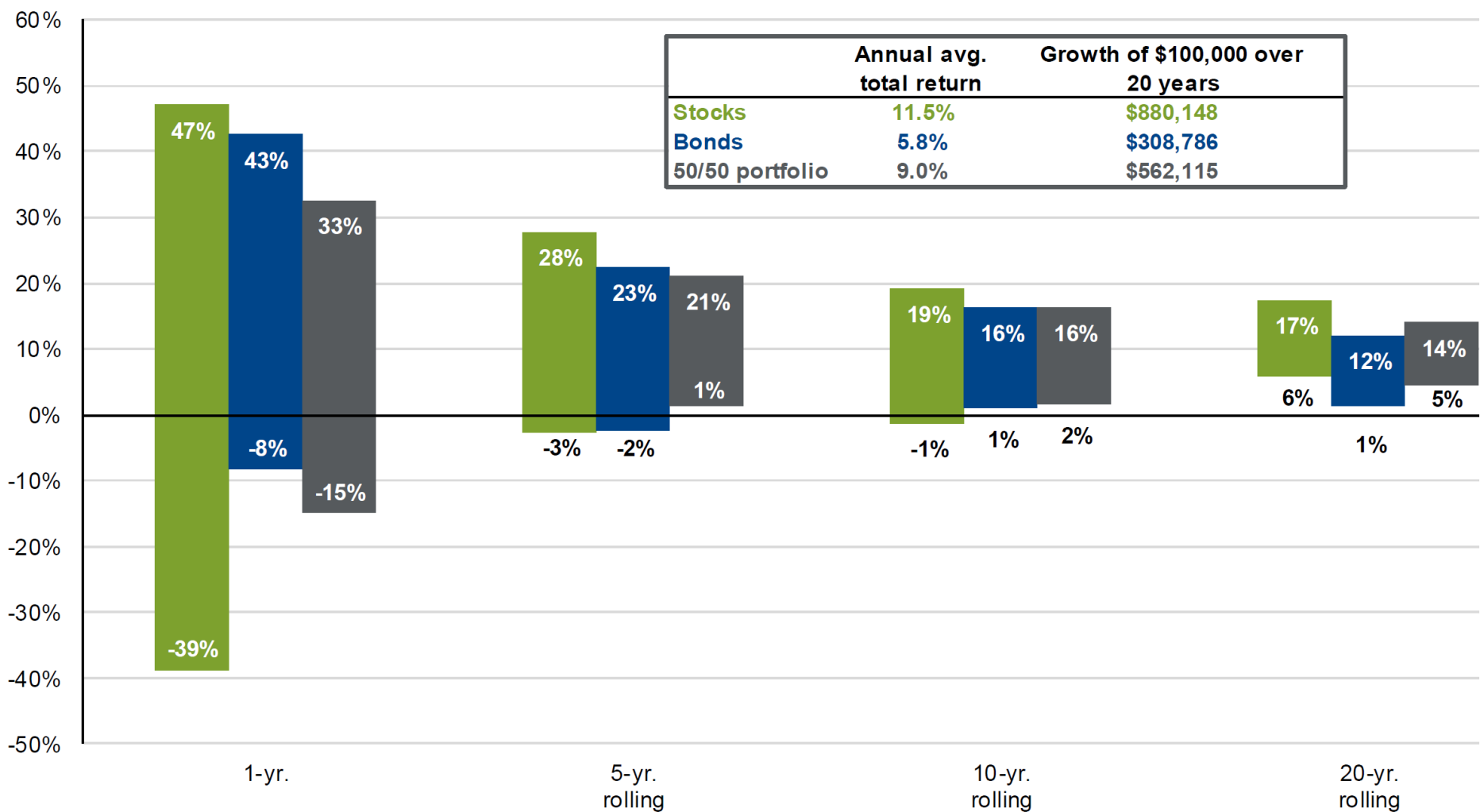
January 2007 - December 2021 (Single Computation)



# Time, Diversification and the Volatility of Returns

## Range of stock, bond and blended total returns

Annual total returns, 1950 - 2021



Source: Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management.  
 Returns shown are based on calendar year returns from 1950 to 2021. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Aggregate thereafter. Growth of \$100,000 is based on annual average total returns from 1950 to 2021.  
 Guide to the Markets - U.S. Data are as of January 31, 2022.

# Common Error: Applying Personal Investment Practices

1. Personal Investment Portfolios Differ Greatly From a Risk Pool's;  
i.e. time horizon, constraints, tax situation.
2. Risk Pooling Practices Also Differ From Endowments, Pension Funds, etc.;
3. Enterprise Risk Management Should Always Be a Consideration;

# Utilize a True Fiduciary

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**Finally, many Trustees do not receive investment advice from a true Fiduciary, which may result in actions that are not in the best interest of your risk pool.**

## **What is a Fiduciary?**

A fiduciary is legally and ethically held to ensuring any financial/investment services and expertise they provide your risk pool is solely in the best interest of your organization (i.e. an investment manager or broker by default is not necessarily a fiduciary).

## Are They a Fiduciary or Not?

Trustees can ask these simple questions to identify if they are receiving investment advice from a Fiduciary (or not):

1. Are they registered for an investment advisor with the SEC?

If “Yes,” then they are a fiduciary.

2. Are they a broker/dealer who is responsible for determining investments?

If “Yes,” then they are NOT a fiduciary.

3. Are they an internal investment professional?

If “Yes,” then probably not as they are held to standards of employment.

4. Unsure? Ask them and get assurances in writing.

# Texas Municipal League Intergovernmental Risk Pool

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Tito P. Villegas, Jr., CPA, CFA

Chief Financial Officer & Chief Investment Officer

# Setting the Stage: Case Study Overview (1)

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## **Texas Municipal League Intergovernmental Risk Pool**

- **\$830MM** Investment Portfolio
- **18 Board Members/Trustees**
  - Consisting of City Managers, Mayors, Appointed Citizens, etc.
- **In July 2019, S.B. 2551 was passed:**
  - **Clarified 11 Presumption Cancers**
  - **Expanded Investment Authority for Current and Future Death & Lifetime Income Benefits Reserves/Equity**



# Setting the Stage: Case Study Overview (2)

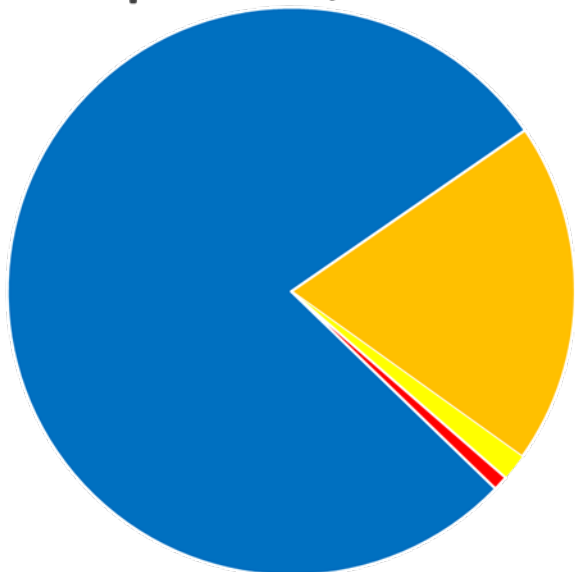
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## TMLIRP's Plan After the Law Went Into Affect:

- **October 2019: Educate/Familiarize Board with:**
  - Expanded Investment Options
  - Investment Process of Other Pools
  - Prudent Person Flexibility
  - Implementation and Operation of New Program
- **January 2020: Develop & Review/Approve Plan with Board**
- **February 2020: Begin Investing & Monitoring Program**

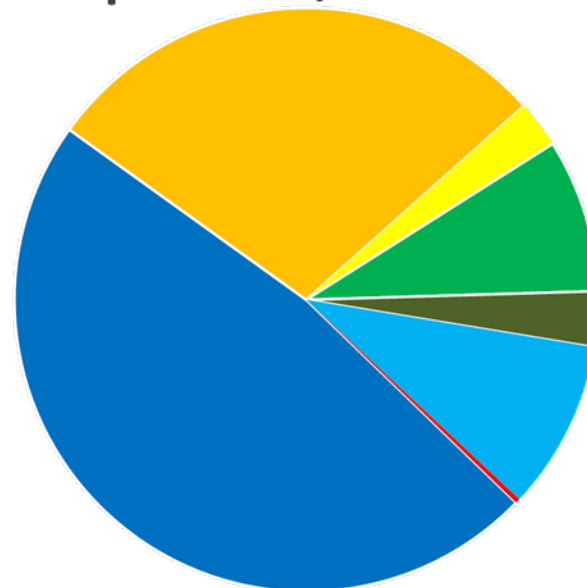
# Before and After

Sept. 30, 2019



Combined Asset Allocation	Market Value & Accrued Interest	Portfolio (%)
Mortgages	\$ 526,869,571	75.3
Municipal Bonds	131,338,588	18.8
Money Market & Accrued Interest	10,115,324	1.4
US Treasury	5,646,792	0.8
<b>Total Market Value</b>	<b>\$ 699,872,605</b>	<b>100.0</b>

Sept. 30, 2021



Combined Asset Allocation	Market Value & Accrued Interest	Portfolio (%)
Mortgages	\$ 360,930,886	47.7
Municipal Bonds	215,796,792	28.5
Money Market & Accrued Interest	19,686,517	2.6
Stock Mutual Funds	64,370,236	8.5
High Yield Corp. Bond Mutual Fund	23,218,266	3.1
Investment Grade Corp. Bonds	70,987,731	9.4
US Treasury	1,868,313	0.2
<b>Total Market Value</b>	<b>\$ 756,858,741</b>	<b>100.0</b>

# Investment Diversification – Investment Income

## Investment Income - Twelve Months Ending September 30

	Govt. Portfolio	LTB Portfolio	Combined
<b>Interest Income</b>	\$ 19,323,358	\$ 1,996,261	\$ 21,319,619
<b>Dividend Income</b>	-	2,291,182	2,291,182
<b>Amortization Expense</b>	(5,598,859)	(891,830)	(6,490,690)
<b>Realized Gains</b>	386,816	97,355	484,171
<b>Investment Income</b>	<b>14,111,315</b>	<b>3,492,967</b>	<b>17,604,282</b>
<b>Unrealized Gains (Losses)</b>	(13,745,249)	11,394,571	(2,350,678)
<b>Invst. Income (w/unrealized gains/losses)</b>	<b>\$ 366,066</b>	<b>\$ 14,887,538</b>	<b>\$ 15,253,604</b>

# Investment Diversification – Investment Returns

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<b><u>Total Rate of Return</u></b>	<b><u>1 Year</u></b>
<b>Consolidated Portfolio</b>	2.3%
<b>Government Portfolio</b>	0.0%
<b>LTB Portfolio</b>	11.4%

# Impact of Unrealized Investment Gains (Losses)

## REVENUES OVER (UNDER) EXPENSES

FISCAL YEARS ENDING SEPTEMBER 30, 2021, 2020 & 2019

(\$ In Thousands)	2021	2020	2019
Revenues Over (Under) Expenses BEFORE Unrealized Gains/(Losses)	(\$33,798)	\$12,801	\$12,971
Unrealized Investment Gains/(Losses)	(2,351)	20,060	37,734
Revenues Over (Under) Expenses AFTER Unrealized Gains/(Losses)	(\$36,149)	\$32,861	\$50,706

## NET POSITION

AS OF SEPTEMBER 30, 2021, 2020 & 2019

(\$ In Thousands)	2021	2020	2019
Net Position BEFORE Cumulative Unrealized Gains/(Losses)	\$344,643	\$378,446	\$369,643
Cumulative Unrealized Investment Gains/(Losses)	36,699	39,049	18,990
Net Position AFTER Cumulative Unrealized Gains/(Losses)	\$381,342	\$417,495	\$388,633

# Understanding Pool Financial Reporting

## STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION

**Earned contributions**

**Reinsurance expense**

**Investment income**

### TOTAL REVENUES

**Losses**

**Operating expenses**

### TOTAL EXPENSES

## CHANGE IN NET POSITION

# Investments – 96% of Total Assets

## CONDENSED STATEMENTS OF NET POSITION

AS OF SEPTEMBER 30, 2021, 2020 & 2019

(In Thousands)	2021	2020	2019
<b>ASSETS AND DEFERRED OUTFLOWS</b>			
Cash, investments, and accrued interest	\$762,279	\$767,440	\$712,277
Capital assets	13,731	14,137	13,445
Other assets	16,624	13,650	15,058
Net pension asset	4,011	2,844	-
Deferred outflows of pension resources	(1,722)	(2,034)	10,624
<b>TOTAL ASSETS AND DEFERRED OUTFLOWS</b>	<b>\$794,923</b>	<b>\$796,037</b>	<b>\$751,404</b>
<b>LIABILITIES</b>			
Estimated ultimate unpaid losses & loss adjustment expenses (net)	378,457	344,586	326,949
Payables	5,854	8,941	1,546
Other liabilities	29,270	25,015	25,499
Net pension liability	-	-	8,777
<b>TOTAL LIABILITIES</b>	<b>\$413,581</b>	<b>\$378,542</b>	<b>\$362,771</b>
<b>NET POSITION</b>			
Invested in capital assets	13,731	14,137	13,445
Restricted	9,701	8,321	18,510
Unrestricted	357,910	395,037	356,678
<b>TOTAL NET POSITION</b>	<b>\$381,342</b>	<b>\$417,495</b>	<b>\$388,633</b>

# Key Considerations & Next Steps

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## Next Steps?

1. Understanding Any Regulatory Constraints on Allowable Asset Classes;
2. Determine the Pool's Risk Appetite (*via Questionnaire and Scenario-Based Analyses*);  
The amount of risk an insurer or risk pool is comfortable taking on within the portfolio will shape the overall investment program.
3. Implement an On-Going Investment Education Process
4. Review Current Asset Allocation and Potential Alternatives;  
How might changes affect the pool's yield, surplus/net position, reserves, etc.



Questions & Answer Session