Section 3.0 INVESTMENT MANAGERS

3.1 MANAGER MONITORING POLICY

Adopted: August 9, 2011

TABLE OF CONTENTS

I. Purpose 265
II. Monitoring and Evaluating 265
III. Newly-Hired Managers 266
IV. Managers "On Watch" 266
V. Quantitative Factors 267
VI. Qualitative Factors 268
VII. Courses of Action 269
VIII. Termination 269
IX. Private Market Managers 270

Exhibit: Notification Letter Sample 271

Section 3.0 INVESTMENT MANAGERS

I. PURPOSE

The purpose of this policy is to:

- establish general guidelines for monitoring the effectiveness of implementing the investment strategies for which the investment managers are retained
- provide a detailed framework and criteria for placing a manager “On Watch” status
- provide a systematic, consistent, and objective framework for recommending or electing to retain or terminate a manager

LACERS’ objective is to determine the likelihood of future success of the strategy; therefore, it is important that retention/termination decisions focus on qualitative aspects of each manager’s investment philosophy, strategy and process, as well as quantitative assessment of past and current performance.

It is also important to consider that each manager’s situation is unique, and must be analyzed on an individual basis, taking into account any unique circumstances affecting the manager and its relationship with LACERS.

II. MONITORING AND EVALUATION

Investment managers will be monitored in the following areas:

1. Investment performance relative to a specific benchmark and an appropriate peer group;
2. Investment risk relative to specific benchmark and an appropriate peer group;
3. Performance per unit of risk relative to specific benchmark and an appropriate peer group (information ratio);
4. Adherence to the investment manager’s philosophy, process, and stated investment style/strategy;
5. Organizational and personnel continuity;
6. Compliance with Investment Manager Guidelines and Investment Policy.

LACERS’ Staff and the General Fund Consultant will review and evaluate investment managers, quantitatively and qualitatively, using the following procedures:

1. Quarterly quantitative review of performance and risk relative to its specific benchmark and an appropriate peer group of active managers over various measurement periods (normally 3 – 5 years);
2. Quarterly review of portfolio characteristics, performance trends, style consistency, and risk expectations (standard deviation and tracking error);
3. Annual due-diligence meeting at LACERS’ office;
4. Every three years (generally) conduct due diligence meeting at the investment manager’s office, unless significant organizational change warrants immediate evaluation;
5. More frequent, detailed and formal review of investment managers “On Watch” (see Section IV).

Following any evaluation, Staff and General Fund Consultant will classify investment managers into one of two categories:

Section 3.0 INVESTMENT MANAGERS

1. **Good Standing**
   An investment manager is in "Good Standing" status if it:
   - Outperforms its specific benchmark, net of fees, over rolling three and five year periods;
   - Produces a rolling information ratio (i.e., risk-adjusted return) of 0.2 or higher over three and five year periods;
   - Is in the top 50^{th} percentile (gross of fees) relative to its peer group (also measured in gross of fees) for the 5-year period and "Since Inception" (subject to data availability);
   - Meets performance objectives, as stated in its Investment Manager Agreement, over a market cycle (defined as five years).

2. **On Watch**
   An investment manager is placed in "On Watch" status if it fails to meet two or more quantitative and/or qualitative factors as listed in Section V and VI.

III. NEWLY-HIRED MANAGERS

Quantitative factors will be evaluated quarterly, but shall not cause a manager to be placed "On Watch" until three years or more after inception, unless the manager demonstrates performance that is materially inconsistent with expectations or experiences organizational issues.

IV. MANAGERS "ON WATCH"

LACERS shall notify investment managers in writing of their status should they be placed "On Watch". Typically, "On Watch" status applies for one year from the initial placement date. However, the review period can be extended beyond the one year period, depending upon LACERS' satisfaction with the progress the investment manager is making or until the investment manager meets the criteria for "Good Standing".

The Board is updated on a quarterly basis of all managers' performance, status, and "On Watch".

Managers "On Watch" will receive no additional funding from rebalancing, contributions or other sources. However, funds may be withdrawn for rebalancing or liquidity needs.

V. QUANTITATIVE FACTORS

Factor	Trigger	Action
Annualized **net** performance relative to its benchmark for trailing **3-years**	Underperforms (net of fees) in 8 of 12 previous quarters	Place "On Watch" and notify manager
Annualized **net** performance relative to its benchmark for trailing **5-years**	Underperforms (net of fees)	Place "On Watch" and notify manager
Moving average tracking error (TE) for **3-years**	Greater than two standard deviations from 'Since inception' mean TE[1]	Place "On Watch" and notify manager
Moving average tracking error (TE) for **5-years**	Greater than two standard deviations from 'Since inception' mean TE[2]	Place "On Watch" and notify manager
Moving average **net** Information Ratio trailing **5-year** relative to its benchmark	Falls below 0.20.	Place "On Watch", if fails another quantitative factor
PASSIVE MANDATES Annualized **net** performance relative to its benchmark for trailing **1-year**	Underperforms (net of fees)	Place "On Watch" and notify manager

[1]Or over at least a 5-year period using pre-hire data if inception less than five years.
[2]Or over at least a 10-year period using pre-hire data if inception less than ten years.

VI. QUALITATIVE FACTORS

A significant and potentially adverse event related to, but not limited to, any of the following qualitative issues or events may result in placing the investment manager on the "On Watch" status or an immediate termination.

Criteria	Factor	Action
Organization	Change in firm ownership and/or structure	Place "On Watch", if determined that change might detrimentally affect performance and strategy
	Loss of one or several key personnel, specifically personnel on LACERS portfolio product	Place "On Watch", if determined the turnover will impair the firm's investment capabilities
	Significant loss of clients and/or assets under management	Place "On Watch", if there is a high client turnover and high volume of outflows
	Significant and persistent lack of responsiveness to LACERS requests	Place "On Watch", if service deterioration inhibits ability to monitor
	Regulatory agencies' investigation and/or material litigation	Place "On Watch", if nature, seriousness, and likely impact of changes on the firm and investment product warrant
Strategy and Risk Control	Deviation from stated investment philosophy, style, and process	Place "On Watch" if deviation persists for more than 4 quarters. Terminate if no longer consistent with LACERS objective
	Risk management controls and procedures	Place "On Watch" for repeated guideline or policy violations

Section 3.0 INVESTMENT MANAGERS

VII. COURSES OF ACTION

After placing an investment manager "On Watch" status, the following steps will be taken:

1. Staff will contact the investment manager and formally inform them of their status in writing. Notification shall indicate the reasons why the firm is "On Watch" and request the investment manager to explain and to provide plan of action to remove itself from "On Watch" status;
2. Staff and/or General Fund Consultant will meet with the investment manager, either in person or telephonically, following receipt of a written response from them;
3. Staff, with input from the General Fund Consultant, shall determine whether the manager should be retained "On Watch" or terminated;
4. Staff shall monitor the progress of the investment manager's implementation of the plan of action;
5. After the initial one year period, Staff and General Fund Consultant shall determine whether to remove the manager from "On Watch" status, continue the "On Watch" status, or terminate the investment manager;
6. Staff and General Fund Consultant shall present the supporting rationale and provide a recommendation to the Board.

If deemed necessary, the Board may request the investment manager to appear before the Board to explain the situation. Non-compliance with respect to the Board request shall be cause for an immediate termination recommendation by Staff to the Board.

VIII. TERMINATION

The Board reserves the right to terminate an investment manager for any reason. Grounds for investment manager termination may include, but are not limited to, the following reasons:

1. Failure to comply with the guidelines agreed upon for management of the Board's portfolio, including holding restricted issues;
2. Failure to achieve performance objectives specified in the manager's guidelines;
3. Significant deviation from the manager's stated investment philosophy and/or process;
4. Loss of key personnel;
5. Evidence of illegal or unethical behavior by the investment management firm;
6. Lack of willingness to cooperate with reasonable requests by the Board for information, meetings or other material related to its portfolios;
7. Loss of confidence by the Board in the investment manager;
8. A change in the System's asset allocation program, which necessitates a shift of assets to another sector.

Staff is authorized by the Board to notify the investment manager in writing that trading on the account must cease immediately. Staff will inform the Board of such action. A termination recommendation for ratification will be scheduled for the next Board meeting.

The Board will carefully review any one of these factors; however, the presence of any one of these factors may not necessarily result in an automatic termination.

All of LACERS investment management contracts allow LACERS to terminate the manager, with or without cause, after 30 days' written notice.

IX. PRIVATE MARKET MANAGERS

The private market portfolio consists of private equity, private real estate, corporate governance, and opportunistic fixed income. This portfolio is made up of individual partnerships that generally last from 10 to 12 years, with provisions for possible extensions beyond the original term. The interim performance of a partnership investment (anything prior to the termination of a partnership) may not always be indicative of the final results for a particular partnership..

The interim valuations of a partnership's underlying investments reflect a high degree of subjectivity. As a partnership's underlying investments are disposed of, either at a gain or at a loss, the interim performance begins to become more indicative of the partnership's final performance level.

The ultimate measure of a partnership's performance is calculated from the total amount of cash that is contributed (paid-in) to the partnership compared to the timing and amount of cash returned to LACERS. The most common measurement tool is calculating a net compound annual internal rate of return (net IRR), which is a discounted cash flow analysis of the cash flows to and from the partnership over the life of the partnership.

Following each quarter end, Staff and Consultant will evaluate each private market managers' for the five criteria articulated in Section II. Managers who fail any of the areas for three consecutive years shall be placed in the "On Watch" status.

EXHIBIT

NOTIFICATION LETTER SAMPLE

[Date]

[Investment Manager]
[Address]

Re: Notice of Placement on “On Watch” Status

Dear [Investment Manager Contact Person]:

This is to advise you that, pursuant to its Manager Monitoring Policy, the Board of Administration of the Los Angeles City Employees’ Retirement System placed [Investment Manager Firm] in “On Watch” status. Firms are placed in “On Watch” status when their investment performance is below expectations, investment risk is outside of reasonable expectations, changes occur in their investment style, or changes within their organization cause the Board concern.

The purpose of LACERS Manager Monitoring Policy is to ensure the highest levels of performance by the investment managers. The process requires regular evaluations of manager performance against specific standards as stated in the Policy (enclosed for your reference).

[Investment Manager Firm] has been placed in “On Watch” status due to [reason, i.e. performance, organization, etc.] [any additional narratives may be added here].

LACERS Staff and/or LACERS General Fund Consultant, Wilshire Associates, will be contacting you to discuss the specifics and your plans for improvement. If deemed necessary, the Board may request you to make a presentation.

During this evaluation period, the [Investment Manager Firm] will not receive any additional funding; however, funds may be withdrawn for rebalancing or liquidity needs. Should the Board continue to be dissatisfied with your portfolio’s performance, changes in your investment style, or changes within your organization, the Board may, in the best interests of the Fund, decide to terminate your contract. The Board retains the right to terminate a manager’s contract at any time during the contract term for any cause or allow the contract to expire, including while a firm is in “On Watch” status.

Should you have any questions or require further information, please do not hesitate to contact me at (213)473-7124.

Sincerely,
[CIO Name]
Chief Investment Officer

cc: Eileen Neill, Wilshire Associates

Section 3.0 INVESTMENT MANAGERS

3.2 EMERGING INVESTMENT MANAGER POLICY

Adopted: February 14, 2012; Revised September 24, 2013

TABLE OF CONTENTS

I. Policy Objectives 273
II. Emerging Investment Manager Goals 273
III. Emerging Investment Manager Minimum Criteria 274
IV. Provisions for Post-Emerging Firms 275
V. Reporting 276

Section 3.0 INVESTMENT MANAGERS

I. POLICY OBJECTIVES

The objective of this Emerging Investment Manager Policy (“Policy”) is to identify investment firms with the potential to add value to the LACERS investment portfolio (“Fund”) that would otherwise not be identified by the standard LACERS institutional investment manager search process. The Board of Administration (“Board”) believes that smaller investment management organizations may generate superior performance returns because of the increased market flexibility associated with smaller asset bases. The Policy provides criteria for LACERS to identify appropriate investment management organizations in their early business stages.

Consistent with the Board’s fiduciary responsibility, the goal of this Policy is to locate and fund emerging investment managers with successful histories of generating positive alpha at an appropriate level of active risk. LACERS may consider an emerging investment manager mandate as part of any investment manager search undertaken by the Board, after Staff and the appropriate Fund Consultant have determined that the emerging manager return and risk characteristics of the mandate under consideration are no less favorable than comparable, non-emerging investment manager opportunities available for that mandate.

The Board recognizes that emerging investment managers do not possess the organizational depth and resources of larger investment management firms, and thus represent a greater business risk. The Board also recognizes that prudent management of the Fund requires that emerging investment managers, once retained, will manage significantly smaller amounts of Fund assets than larger investment management firms. Each of these issues will result in greater oversight and administrative responsibilities for Fund staff, and will consequently be part of the evaluation whenever emerging investment managers are being considered for inclusion in a manager search.

Managers hired pursuant to this Emerging Investment Manager Policy will be held to accountable to the same performance, reporting, and retention standards as all other LACERS investment managers within the same asset class.

II. EMERGING INVESTMENT MANAGER GOALS

<u>Public Markets</u>: The Emerging Investment Manager aspirational policy goal for public market asset classes is 10%. Two metrics will be calculated at least annually to compare actual results versus the goal: 1) Asset Class Metric: total market value of all emerging investment managers accounts within a respective public market asset class divided by total market value of the respective public market asset class; and 2) Manager Search Metric: total dollars approved for contract with an Emerging Manager(s) divided by the total dollars approved for funding the respective investment manager search.

<u>Private Markets</u>: The Emerging Investment Manager aspirational policy goal for private market asset classes is 10%. Two metrics will be calculated at least annually to compare actual results versus the goal: 1) Asset Class Metric: total dollar commitments of all emerging investment manager partnerships within a respective asset class divided by the total dollar market value of the respective asset class; and 2) Manager Search

Metric: total dollar commitments provided to Emerging Managers within a specific private market asset class divided by the total dollar value of all investment commitments in the same private market asset class over rolling 36 month periods.

III. EMERGING INVESTMENT MANAGER MINIMUM CRITERIA

The following minimum criteria for firms to qualify as LACERS Emerging Investment Manager status under this Policy are as follows:

A. Public Market Asset Classes – *U.S. Equities, Non-U.S. Equities, Core Fixed Income*

1. The firm will have no more than $2 billion in total firm assets under management at the time of hire.

2. The firm must have a minimum of $50 million assets under management in the strategy being considered.

3. The firm must have been in existence for a minimum of one year.

4. The portfolio manager must have a minimum of five years of verifiable experience managing the strategy being considered. The experience must include a GIPS-compliant performance track history attributable to the portfolio manager for the most recent 36-month period of the five-year verifiable experience requirement.

5. No person or entity, other than the principals and/or employees of the firm, shall own more than forty-nine percent (49%) interest of the firm.

6. At the time of hire, funding in the investment strategy shall not exceed 20% of the total strategy AUM at the time of actual funding.

B. Private Market Asset Classes – *Private Equity, Real Assets (not including Real Estate), Credit Opportunities*

1. The General Partner will have no more than $500 million in firm-wide assets plus unfunded commitments under management at the time LACERS makes its commitments.

2. First or second-time institutional fund for a General Partner.

3. The Fund* shall have a minimum fund size of $100 million in committed capital inclusive of LACERS' pending commitment.

4. The firm must have been in existence for a minimum of one year.

5. The firm must have a minimum track record of five years. Any firm with a track record of less than five years may utilize track records established at prior firms when performance can be clearly attributed to the emerging firm's key individuals and/or the specific team associated with the strategy being considered.

6. No person or entity, other than the principals and/or employees of the firms, shall own more than forty-nine percent (49%) interest of the firm.

7. No Limited Partner can represent more than 30% of the total Fund's* capital.

8. LACERS' commitment in the strategy being considered shall not exceed 10% of the projected final closing fund size or $20 million, whichever is lower.

**Excludes co-investments or sidecar investment vehicles.*

C. <u>Private Market Asset Classes – *Private Real Estate*</u>

1. The General Partner will have no more than $500 million in firm-wide assets plus unfunded commitments under management at the time LACERS makes it commitment.

2. First or second-time institutional fund for a given General Partner.

3. The Fund shall have a minimum fund size of $150 million in committed capital inclusive of LACERS pending commitment.*

4. The firm must have been in existence for a minimum of one year.

5. The firm must have a minimum track record of five years. Any firm with a track record of less than five years may utilize track records established at prior firms when performance can be clearly attributed to the emerging firm's key individuals and/or specific team associated with the strategy being considered.

6. No person or entity, other than the principals and/or employees of the firm, shall own more than forty-nine percent (49%) interest of the firm.

7. No client can represent more than 30% of the total Fund's capital.

8. LACERS commitment in the strategy being considered shall not exceed 10% of the projected final closing fund size or $20 million, whichever is lower.

**Excludes co-investments or sidecar investment vehicles.*

IV. PROVISIONS FOR POST-EMERGING FIRMS

A. <u>Public Markets</u>

LACERS expects that successful emerging investment management firms will grow beyond the maximum $2 billion in assets under management. An emerging investment manager firm under contract to LACERS that successfully grows its assets under management and meets the minimum investment manager search criteria may be considered for a larger-sized mandate subject to (at minimum) meeting the Manager Search and Selection Criteria provided in the LACERS Manager Search and Selection Policy.

B. Private Markets
LACERS expects that successful emerging investment management firms will grow beyond raising first and second-time partnership funds. Opportunities for participating in subsequent funds may be considered provided that the strategy meets the criteria of LACERS' Alternative Investment Policy, Real Estate Policy, Credit Opportunities Policy, or another asset class policy unique to a respective private markets mandate.

V. REPORTING

Staff will report to the Board on the status of Emerging Investment Managers hired and retained on an annual calendar year basis. The annual report will include:

1) Names of Emerging Investment Manager firms hired during the calendar year.
2) Dollar amounts awarded to Emerging Managers.
3) Report of Emerging Investment Manager Goals Metrics pursuant to Section II of this Policy.
4) List of all investment manager searches.
5) Staff and consultant efforts to increase the visibility of LACERS Emerging Investment Manager searches and Emerging Investment Manager representation within the total Fund portfolio.
6) Emerging Investment Manager performance data.