

Section 3.0 INVESTMENT MANAGERS

3.1 MANAGER MONITORING POLICY

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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:

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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 50th 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.

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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

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

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

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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

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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.

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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.

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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