



# EMPLOYEES' RETIREMENT SYSTEM

The Maryland-National Capital Park and Planning Commission

## **MANAGER MONITORING POLICY**

### **I. PURPOSE**

The purpose of the Manager Monitoring Policy (the “Policy”) is to establish the process and discipline for managing the investment manager relationship. The goal of the Policy is to implement a process that

- Retains managers with value-adding capabilities.
- Terminates managers with no positive value-adding capabilities.

This Policy sets forth the responsibilities, objectives and criteria for the Manager Monitoring Policy.

### **II. INTRODUCTION**

Under the direction of the Board of Trustees (“Board”), the investment consultant, the Investment Monitoring Group (IMG) and the Administrator shall monitor investment managers in order to

- Evaluate whether managers have achieved their stated investment objectives;
- Ensure that managers adhere to their specific investment process; and
- Assess the impact of any significant investment firm changes, such as staff, client base, ownership or legal/financial issues.

In monitoring managers, all information about the ERS’ investment managers that may materially impact the relationship and investment objectives should be considered. Due to the significant costs involved in replacing managers, and due to the substantial probability of selecting a non-positive value-adding manager as a replacement for an existing manager, the Policy is biased toward avoiding terminating managers with positive value-adding capabilities.

### **III. RESPONSIBILITIES**

- A. The Board is responsible for overall management of the Fund’s investment program. This shall include the asset allocation plan, investment structure, investment performance, selection and termination of investment managers and compliance with guidelines.

- B. The Investment Consultant is responsible for assisting the Board in establishing and monitoring investment policy and strategy. The Investment Consultant will recommend and monitor asset allocation and investment management guidelines, and will prepare quarterly performance measurement reports. Upon request, the Investment Consultant will assist with manager searches, and other special assignments as directed by the Board. The Investment Consultant will report all material investment manager issues to the Administrator and the Board and recommend manager changes if in the best interest of the Fund.
- C. The Investment Monitoring Group is responsible for monitoring investment performance and performing investment related assignments as directed by the Board. The IMG may make recommendations to the full Board.
- D. The Administrator is responsible for the day-to-day management of this Policy and communication with investment managers to accomplish objectives as set by the Board.
- E. The Investment Manager is responsible for managing the investment portfolio in accordance with the Investment Management Guidelines provided by the Board.

#### **IV. OBJECTIVE**

The objective of the monitoring process is to identify on a timely basis signs of adverse changes in a manager's organization or investment process. Monitoring involves the analysis of both qualitative and quantitative factors.

#### **V. MANAGER EVALUATION**

- A. Each Active Manager will be evaluated at least annually by the Investment Consultant or the IMG. The evaluation will include both qualitative and quantitative factors. The results of the review will be documented in a report to the Board. It is understood that the Board reserves the right to evaluate a manager at any time it chooses.
- B. The on-going monitoring of investment managers by the Investment Consultant and the IMG will include both qualitative and quantitative analysis. Qualitative monitoring involves reviewing the following organizational aspects:
  - 1. Ownership structure
  - 2. Staffing
  - 3. Growth (Client base, products, and level of assets under management)
  - 4. Client service (plans/staff)
  - 5. Investment philosophy and style
  - 6. Investment process

7. Level of commitment to the product type
8. Adverse organizational issues as measured by the existence of litigation or other investigations, regulatory issues or financial problems.

In order to remain current with changes in each manager's organization, frequent and meaningful communication with the manager, consistent with the ERS' Ethics Policy, is critical. No Trustee should solicit information from managers directly as the Ethics Policy directs that communications with the Investment Managers must be through the Administrator. The Administrator is required to maintain a communications log and report communication to the Board.

Communication with a manager includes, but is not limited to, the following:

- Contact via telephone and fax
- Monthly, quarterly, and annual reports from managers, including commentaries regarding investment strategies and active deviations from the benchmark.
- A minimum of one presentation per year to the Board or IMG. Meeting agenda items include a clear articulation of strategies recently employed; the purpose and effectiveness of those strategies; an update on the current strategy and outlook. Managers should follow the Investment Manager Presentation Requirements.
- Client conferences.

Even the most positive value-adding investment management firms may experience adverse circumstances, such as underperformance, personnel changes, and loss of assets under management. When managers experience such events, the Investment Consultant will evaluate whether appropriate action was taken by the manager, what impact the action could have upon the portfolio in the future, and what other actions may be considered.

- C. Quantitative monitoring requires the analysis of the implementation of the investment approach. The following are examples of quantitative factors that shall be reviewed:
  1. Risk / return analysis of the portfolio relative to an appropriate benchmark.
  2. Comparisons to the benchmark should be annualized since inception, five-year, three-year, one-year, year-by year, and year-to-date periods. Returns should be net of fees.
  3. Portfolio characteristics comparisons of the portfolio and the benchmark.
  4. Attribution analysis.
  5. All benchmarks should be reviewed a minimum of every two years to determine its suitability for a given manager's style.

## **VI. FACTORS WHICH MAY TRIGGER ADDITIONAL DUE DILIGENCE**

A. Factors leading to additional due diligence are expected to be triggered infrequently. Key triggering factors include:

1. Adverse changes experienced within a manager's organization as related to the qualitative factors in the on-going monitoring section.
2. Sustained and significant return underperformance relative to an appropriate benchmark and investment objectives per the manager's Investment Guidelines:
  - a) Long term underperformance
  - b) Rolling 3-year returns that are below the benchmark for 4 consecutive quarters.
3. A manager's style or strategy is no longer appropriate for the investment program
4. A request by the M-NCPPC ERS Investment Board

B. Results of the Evaluation

1. Based on the evaluation, the Investment Consultant may recommend that a manager be placed on Watch list Status or Dismissed. Similarly, based on the evaluation, the IMG may make recommendations to the Board up to and including dismissal. The ERS Board decides if a manager is placed on Watch list Status or is dismissed.
2. Watch List Status – Indicates a heightened level of concern that shall be unique to each situation and quantified by the Investment Consultant to the Board. The level of concern can range from minor to major deficiencies. A recommendation for Watch List Status shall designate a period of time to assess the capabilities and quality of a Manager's operations and include more frequent contact with the firm to monitor the conditions that led to the Watch List Status. Managers placed on Watch List Status must be notified in writing and may be requested to submit additional information on a monthly basis or a Plan of Action to address the deficiencies and shall typically remain on Watch List Status for performance-related issues or organizational changes for up to one year to ensure that outstanding issues are resolved. Managers who do not correct outstanding issues in a timely manner shall be considered for Dismissal.
3. Dismissal – The Investment Consultant shall recommend Dismissal of a manager if adequate improvement in the areas outlined in the Plan of Action has not been made; however, the Investment Consultant may recommend Dismissal for any reason. Notification of dismissal must be provided in writing.

C. Comprehensive Qualitative and Quantitative Evaluation Conclusions

In order to make a more fully informed retain-or-terminate decision, additional considerations must be taken into account. Considerations include:

1. The direct costs of replacing managers are significant, from 1% - 4% of the portfolio's market value.
  2. If the manager is terminated, what alternatives exist in redeploying the portfolio assets? Alternatives include:
    - a) Hiring a new manager with a similar style
    - b) Transferring assets to an existing, similar style manager
    - c) Distributing assets among various existing managers
  3. Key questions to address in making the retain/terminate decision include:
    - a) Would the manager be hired today?
    - b) What has fundamentally changed since the manager was hired?
    - c) Are the changes significantly adverse?
    - d) Are there plausible solutions to the adverse changes?
    - e) What are the long-term, medium-term, and short-term prospects for the manager?
- D. A report will be delivered to the M-NCPPC ERS Board by Investment Consultant on the manager and will include:
1. The recommendation to retain, place on Watch List, or terminate the manager
  2. Detailed rationale for the recommendation
  3. In the event of a termination recommendation, include alternatives for transfer of assets or the transitional management of assets.

## **VII. REPORTING REQUIREMENTS TO THE M-NCPPC ERS INVESTMENT BOARD**

- A. Periodic investment consultant presentations of results from the monitoring program
- B. Periodic reports of changes in manager organizations from the Investment Consultant, the IMG or the Administrator
- C. Quarterly and annual reports on performance of investment funds from the Investment Consultant
- D. Quarterly reports from the IMG as requested by the Board.

## **VIII. DOCUMENTATION GUIDELINES**

A comprehensive file should be maintained for each of the managers, to include, but is not limited to:

- A. Legal documents
- B. Investment management guidelines
- C. Correspondence
- D. Any written reports or recommendations
- E. Performance results, attribution, and analysis
- F. Other relevant information

Written summaries of manager meetings, including key issues to focus upon going forward.

Approved by the Board of Trustees on September 2, 2003 at the Regular Board of Trustees Meeting.

Amended by the Board of Trustees on April 1, 2008 at the Regular Board of Trustees Meeting.