

BOARD OF INVESTMENT TRUSTEES

**MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS and
RETIREE HEALTH BENEFITS TRUST**



SERVICE PROVIDER PROCUREMENT POLICY

Amended: May 16, 2008
January 11, 2008
December 7, 2007
December 2, 2005
September 6, 2002

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SERVICE PROVIDER PROCUREMENT POLICY
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I. Purpose & Authorities

A. Purpose of Policy Statement/Board Requirements

The purpose of this statement is to define the policy of the Board of Investment Trustees (the “Board”) regarding the procurement of external service providers. These services are required in the management of the investment programs for the Employee Retirement Plans (the “ERP”) which include the Employees’ Retirement System, Retirement Savings Plan and Deferred Compensation Plan and the management of the investment program for the Retiree Health Benefits Trust (RHBT). The policy statement is a guideline for the Board’s procurement process, which is intended to foster competition and fairness while being flexible to meet the needs of a dynamic investment environment.

This policy does not cover procurement of Board office administrative services, which generally follows established County contracts and procedures (i.e., procurement of supplies, mini-contracts, etc.) and is set forth in the Board’s Administrative Manual.

B. Statutory Board Responsibility and Authority to Contract for Services

Pursuant to Section 33-60 and 33-162 of the Montgomery County Code, the Board has the fiduciary responsibility for the governance of the ERP and RHBT investment management programs and has exclusive authority to contract for services to meet this responsibility.

C. Board Exemption from County Procurement Regulations

Pursuant to Section 33-60 and 33-162 of the Montgomery County Code, the Board is exempt from the Montgomery County Government procurement regulations in the procurement of services for the management of ERP and RHBT assets. However, as detailed in this policy, the Board adheres to a competitive procurement process in the procurement of service providers.

D. Communications Responsibilities

Official communications related to Board procurement processes and activities will be coordinated by Board Staff. Staff will report items of significance to the Board as appropriate.

II. Procurement of Service Providers - Procedures

A. Stage 1 – ERP and RHBT Program requirements

- The Board will determine the services necessary to meet the goals of the program, including:
 - Hiring/Terminating of service providers
 - Number of service providers sought
 - Urgency/timeframe for search

- Consultant support required

B. Stage 2 – Research Process

This stage involves determining search criteria and sources and the list of possible candidates that may meet Board needs as specified in Stage 1.

1. Criteria

Appendix A lists specific search criteria typically used for the selection of investment managers and vendors (“service providers”) for the ERP and RHBT. The Board or Staff may add additional criteria to be used in a particular search.

2. Candidate sources

Although not limited to the sources listed below, Staff will generally use these sources to identify eligible candidates. Staff may also use sources identified by the Board’s consultant. The Board or Staff may recommend additional sources to be used in a particular search.

- Consultants’ databases including but not limited to:
 - Board consultant database
 - Software databases provided by other vendor(s)
- Industry reports, newspapers, newsletters and articles
- Marketing materials received by Board office
- Plan sponsor and plan sponsor contacts
- Reports and sources used to identify minority-, female-, and disabled-owned firms (MFD)
- Montgomery County resources and information

3. Minority Participation

The Board, Staff and consultants are committed to including minority-, female-, and disabled-owned firms (MFD firms) among prospective service provider candidates. Special efforts made to ensure identification of possible eligible firms in the search process include:

- regular monitoring of above-referenced sources to identify possible candidates
- regular review of service providers utilizing MFD firms
- staff interviews with MFD firms on an ongoing basis
- maintenance of research files on such firms to assist efforts when searches begin

4. Selection of Candidates

Based on criteria and sources noted above, Staff will prepare a list of possible candidates for a specific search. Staff, with the assistance of the investment consultant, will issue a Request For Information to the candidates selected.

Due to the nature of alternative investment opportunities for the Employees' Retirement System and the RHBT, Staff may not always issue a Request for Information. Staff may identify opportunities based on criteria identified in Stage 2 and will evaluate the opportunity based on the criteria identified in Stage 3.

C. Stage 3 – Review and Verification Process

Stage 3 of the search process focuses on review and verification of information pertaining to the list of candidates identified in Stage 2. Completion of the Stage 3 process should result in the selection of a finalist.

1. Due diligence evaluations

Staff will complete a due diligence process to confirm findings identified in Stage 2. Those candidates deemed to be eligible will be interviewed by staff by phone or in person in the Board's office. Staff will prepare a summary of the candidate's evaluation which will include but is not limited to:

- Quantitative information resulting from Stage 2 criteria.
- Qualitative information related to candidate's experience, strategies and operations including:
 - organizational structure
 - experience and depth of personnel, including turnover
 - firm-specific operational philosophy
 - fees
 - references from Board consultant(s)
 - references from other sources
 - in the case of limited partnership arrangements such as private equity, real estate or hedge funds, fund-specific aspects including but not limited to liquidity and tax issues.
 - firm-specific legal/litigation issues

2. Selection of finalists

Staff will conduct a due diligence review of the candidates which will include an interview, and prepare a report with input from the Board consultant resulting in a recommendation of a finalist(s) to the Board. The selection of the finalist(s) will be based on both quantitative and qualitative evaluations as well as interviews.

3. Contracting

After Staff has selected any finalist(s), Staff will ensure that there are no issues with the service provider to prohibit the Board from entering into a contract.

D. Stage 4 – Selection of Finalist(s) and Contract Process

The Board will vote on Staff's recommendation of any service provider(s) at a meeting of the Board pursuant to Board bylaws. Staff, in conjunction with its General Counsel, will handle the contract process.

1. Vote

The Board will vote based on all information made available by Staff, including information on the entire search process as summarized by Staff, subsequent materials prepared for Board consideration, final interviews and due diligence meetings, as applicable. The Board will vote by formal resolution.

If the Board does not vote to accept Staff's recommendation, then the Board will determine at what stage to recommence the procurement process.

2. Contract process and negotiations

Staff will pursue contract negotiations, including terms related to fees, operational issues and guidelines, and will apprise the Board if needed.

A. Separate account agreements may follow a format approved by the Board and will include provisions for:

- establishment of the account and assignment of management and fiduciary responsibility if required
- directions pertaining to the operations of the account
- directions pertaining to Board and Staff authorities and communications
- determination of professional liability insurance for errors and omissions
- establishment of fee and terms of invoicing and payment
- contract termination upon notice by either Board or service provider
- delivery of any other federal or state regulatory required disclosures prior to contract execution
- County-required specifications related to nondiscrimination in contracting and ethics rules
- addenda related to Board policies and procedures, and operational guidelines

B. All service provider agreements will be reviewed by Staff and the Board's general counsel to confirm conformance with Board policies and authorities.

3. Contract execution

All agreements and contracts will be approved and executed in accordance with Board bylaws and signature authorities specified in Board resolutions.

III. Monitoring of Service Providers

A. Review process

Staff will conduct contract compliance reviews on an ongoing basis, including reviews of service provider performance, conformance to guidelines, organizational structure and any other performance requirements as specified in the service provider's contract. Service provider related matters other than performance and contract compliance matters, will be reported to the Compliance and Audit Committee when deemed significant, i.e. if the matter(s) have a possible effect on the service provider's ability to perform as expected. Staff will apprise the Board of performance issues and make recommendations to the Board as necessary. The Compliance and Audit Committee will assess compliance issues and make recommendations to the Board as necessary.

Annually Staff will conduct reviews of all aspects of the service provider's contract. The review may include a due diligence review in the service provider's office or the Board's office when necessary. Matters to be reviewed include but are not limited to the quantitative and qualitative factors which served as the basis for selection as a service provider.

Annually the Compliance and Audit Committee will review and report compliance by Board vendors with contract disclosure requirements

B. Contract modifications

Staff will advise the Board of any suggested modifications to the contract terms, (e.g. service provider ownership changes), whether requested by the service provider or by Staff. Staff, with the assistance of General Counsel, will determine the appropriate method of modification, i.e. contract amendment or letter agreement. Staff will recommend an approval method and background information required by the Board to consider any such modification. Staff will prepare an annual report to the Board reflecting recommendations of modifications to service provider contracts. Pursuant to Board bylaws, the Board will approve contract modifications through Board resolution which will be implemented by Staff and executed in accordance with Board bylaws and signature authorities.

IV. Termination of Service Providers

A. Basis for termination

The Board may terminate a service provider at any time. Contract terms must provide for immediate termination upon written notice by the Board. Alternative investments may not be easily liquidated and therefore immediate termination may not be possible. The Board may terminate service providers for any reason, including but not limited to one or more of the following reasons:

- ERP or RHBT program changes
- Changes in the following:
 - people and organization of the firm
 - philosophy and process of investment strategy

- resources dedicated to the investment strategy
- performance of the product that is being reviewed

- Service providers -specific issues related to lack of adherence to contract terms or guidelines or any other changes in the service provider's business strategies.

B. Procedures

Staff will provide background information regarding any basis for termination of a service provider. Action to terminate a service provider must be by Board resolution. Staff will determine and implement the appropriate account transfer/liquidation procedures, informing the Board as necessary.

V. Records Retention

Staff will maintain service provider records in the Board office. Service provider records will include search-related materials presented to the Board at the time of selection as well as legal and correspondence files. Records will be retained in accordance with Board office procedures. After the service provider relationship has ended, Staff will archive records in accordance with the Board office's records retention policy.

VI. Ethics

The Board, and as applicable, Staff, will at all times conform to Standard of Professional and Ethical Conduct, County ethics laws, rules and regulations related to procurement and involvement with service providers and the Standards of Professional and Ethical Conduct adopted by the Board. In addition to County ethics laws, rules and regulations, individual Board and Staff members will disclose to the Board any inherent or potential conflicts of interest in dealing with specific service providers prior to taking any official action concerning any service provider.

Any violation of County or Board ethics rules by any Board or Staff member will be handled in accordance with County Government and Board procedures.

VI. Policy Review

Staff and/or the Board will review and recommend amendments to this policy as necessary.

Appendix A

Search criteria for the procurement of investment advisor services

A. Specification of needs

When the Board has determined the need for investment management services, it will make changes that are deemed appropriate based on the analysis of a plan's risk and return profile. Changes are expected to improve the risk adjusted return. Specific investment advisor contracting needs required to accomplish the effective management of the ERP and the RHBT will be at the sole discretion of the Board.

B. Criteria to be used for Investment Advisors procurements

Based on investment specific needs, Staff will recommend a list of criteria for determining eligible candidates. The initial criteria will pertain to minimum requirements related to investment management experience in the specific investment sector/strategy sought by the Board:

1. institutional quality product/strategy with proven track record
2. years in business (minimum 3 years for firm or product, unless waived)
3. assets under management (minimum \$100 million, with at least \$40 million in product, unless waived)
4. investment performance (minimum performance requirements include index-like return net-of-fees in asset class for trailing 3 to 5 year periods, and above median performance in investment advisor peer comparisons for trailing 3 year periods, unless waived)

C. Due diligence review by staff

As part of the processes outlined in the Section D of Service Provider Procurement Policy, Staff will perform on site due diligence reviews of service providers at their location. The review will cover the following items:

- people and organization of the firm
- philosophy and process of investment strategy
- resources dedicated to the investment strategy
- performance of the product that is being reviewed

Along with this review, Staff will prepare a written report following the outline as shown in Attachment 1. This form may also be used for monitoring purposes of existing service providers, whenever a visit is performed by Staff.

Attachment 1
Due Diligence Outline for Service Providers Evaluation

Firm:
 Evaluation by:
 Onsite visit: _yes ___no

Product Type:
 Date of Evaluation:

People/Organization	Scoring	Score	Comments
	0-100		
Ownership/Incentives <ul style="list-style-type: none"> • Direct ownership • Phantom stock • Profit-sharing • Performance bonus • Depth of incentives 	Total 0-25		
Assets Under Management <ul style="list-style-type: none"> • Firm-wide growth of assets • Continuity of product lines • Capacity constraint 	Total 0-10		
Quality of Key Professionals/Team <ul style="list-style-type: none"> • • Role of Professionals • Quality of leadership and motivation • Experience(years in industry/ with the firm/ on the team) • Turnover of senior professionals (3 yrs) <ul style="list-style-type: none"> • Quality of education and ongoing education • Interaction with other departments (research, operations) • 	Total 0-50		
Commitment to Improvement <ul style="list-style-type: none"> • Clear mission statement/ Business plans • Reinvestment • Process enhancement/ improvements • Conflict of Interest • Business Continuity Plan 	Total 0-15		

Philosophy/Process	Scoring	Score	Comments
	0-100		
Research-Idea Generation <ul style="list-style-type: none"> • Clear -identification • Permanent or temporary • Unique sources • Unique processing 	Total 0-40		

Portfolio Construction <ul style="list-style-type: none"> • Benchmark orientation • Risk controls • Buy/sell discipline • Return consistency • Style consistency 	Total 0-60		
Resources/Systems			
	0-100		
Research (Alpha Generation)	Total 0-40		
Information/Risk Management Systems	Total 0-15		
Client Service/Administration/Back office	Total 0-15		
Trading <ul style="list-style-type: none"> • Turnover relative to process • Sophistication of trading Process (# of independent traders, experience of traders, systems) • Measurement of trading costs 	Total 0-30		
Performance	0-100		
Fees			

Other Notes on the Service Provider and Conclusions