

***STATE BOARD OF ADMINISTRATION OF
FLORIDA (SBA)
INVESTMENT MANAGER MONITORING
GUIDELINES***

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I. Overview

Investment manager retention and termination decisions have high costs, whether to retain unskilled managers for too long, terminate a skilled manager prematurely or transition assets between managers. Additionally, the variability of most managers' returns complicates straightforward evaluations of skill. Without comprehensive assessments of manager skill, the SBA has little assurance that the manager hired today will perform better than the manager terminated yesterday.

These Investment Manager Monitoring Guidelines ("Guidelines") provide a systematic, consistent, and diligent framework for manager retention and termination decisions to help avoid untimely and haphazard actions that may adversely impact fund returns. In addition, the Guidelines are intended to:

1. Foster a long-term approach to manager evaluations that is forward looking.
2. Provide a systematic quantitative framework to evaluate manager skill that is balanced against qualitative assessments of factors relevant to future performance.
3. Improve client/manager communication by apprising each manager of the quantitative and qualitative standards by which they will be judged, and the near-term and long-term consequences of failing to meet these standards.
4. Promote timely and appropriate responses to actual and potential performance issues.
5. Provide flexibility to allow application across all public markets asset classes, management styles, and market environments.

The Guidelines apply to all of SBA's public markets managers. Inevitably, each retention/termination assessment will have unique circumstances. Accordingly, it is intended that the Guidelines be flexible enough to account for specific manager, asset class, and market-related factors, but, it is also intended that exceptions to the Guidelines be rare.

II. Investment Manager Monitoring Procedures

The SBA will monitor and evaluate the performance of its internal and external investment managers and will observe the following procedures:

1. Quarterly quantitative review of performance relative to an appropriate market index (the contractual benchmark) and an appropriate peer group of active managers over various measurement periods. Passive managers will be compared only to the benchmark market index.
2. Annual review of portfolio characteristics and pattern of performance to evaluate style consistency and level of risk.
3. Annual review of manager organization which may occur on-site, at the SBA offices, or the investment consultant's offices, unless significant organizational change warrants immediate evaluation.
4. Upon placing a manager on the "Watch List", a formal review will be undertaken, as described in Section IV.

Time Horizon

The SBA acknowledges that fluctuating rates of return characterize the securities markets, particularly during short-term time periods. Accordingly, the SBA has principally adopted a three to five year horizon in evaluating managers relative to established benchmarks and peers.

Investment Consultant Role

The SBA will utilize independent and expert resources from the public market investment consultant (“Consultant”) to supplement internal staff resources applied to monitoring managers and developing manager termination/retention actions. The SBA will receive input from the Consultant as follows:

1. The Consultant will quarterly and annually review each investment manager relative to qualitative and quantitative factors.
2. The Consultant will recommend Watch List assignments. The Consultant will also prepare a list of managers who have breached a Watch List factor, but are not recommended for Watch List either due to minor deviations in performance or a deviation explained by specific circumstances.
3. The Consultant will recommend Retention Reviews of Watch List managers, and conduct such Reviews.
4. The Consultant will recommend manager termination/retention actions.

Manager Evaluation, Watch List, and Termination Standards

The SBA acknowledges that, as a result of exercising its fiduciary duty to monitor its investment managers, it may from time to time need to give consideration to replacing managers that are not achieving expected performance. **The SBA reserves the right to place managers on Watch List, and terminate/retain managers in its sole discretion, but the SBA has deemed it appropriate to set out objective standards and utilize an expert Consultant to help formulate such decisions.**

If an investment manager fails to meet the Watch List standards defined in Section II, the SBA, subject to a thorough review of the manager’s organization and investment process, may decide to terminate a relationship. Additionally, certain extraordinary events may be the basis for an immediate termination, regardless of historical performance, including, but are not limited to:

1. Revisions to the business plan of the Manager
2. A key decision maker leaves the Manager
3. A rapid increase/decrease in accounts or assets under management at the Manager
4. A significant change in the investment philosophy of the Manager
5. Manager is involved in material litigation, fraud or conflicts of interest
6. Manager experiences material client-servicing problems

In evaluating investment managers for the purposes of Watch List and retention/termination, the SBA will consider qualitative factors likely to impact the future performance of the portfolio in addition to current and historical rates of return. Although quantitative assessments of manager success are useful in judging whether managers have been successful in the past, they can be poor predictors of future success. Since the SBA’s goal is to determine the likelihood of future success, it is important that retention/termination decisions focus on the qualitative aspects of each manager’s investment process, as well as quantitative assessments of past performance. Section IV (i.e., Table 4) contains relative weightings of qualitative and past performance categories to be applied by the Consultant in conducting Retention Reviews.

III. Watch List

The purpose of a Watch List is to define the conditions that will cause the SBA to formally evaluate the continued retention of an investment manager (see Section IV). Placing a manager on the Watch List is an intermediate step toward either resolving the problem or terminating the manager. The qualitative and quantitative conditions for placing a manager on the Watch List are described below.

If the SBA determines that the conditions which caused the manager to be placed on the Watch List have not been resolved the relationship will be terminated. Consistent with Section IV, one-year will be the time period over which improvement, resolution or a Retention Review will occur for managers placed on Watch List. However significant continued deterioration of performance or additional extraordinary events may result in a SBA decision to terminate earlier.

Qualitative Factors

Below are qualitative factors that will be monitored and may result in placing the investment manager on the Watch List or terminating an investment manager.

Table 1: Watch List Criteria for Active and Passive Managers

Factor	Action Steps
Intentional deviation from stated investment style and philosophy	Place on Watch List. Terminate if no longer consistent with SBA's objectives.
Changes in ownership / business plan	Place on Watch List, if determined that change might detrimentally affect performance.
Client Servicing	Place on Watch List, if service deterioration inhibits ability to monitor. Terminate if issue is not resolved.
Turnover of key personnel on SBA's portfolio product	Place on Watch List. Terminate if the turnover will impair the firm's investment capabilities.
Material change in clients/AUM in SBA's portfolio product	Place on Watch List, if determined that change might detrimentally affect performance.
Advent of material litigation	Place on Watch List, if nature, seriousness and likely impact of charges on the firm and investment product warrant.
Deterioration in Consultant's qualitative scoring of portfolio product to below the median peer	Place on Watch List, if it is determined that the deterioration reflects factors that might detrimentally affect performance.

Quantitative Factors

Below are the quantitative factors that will be reviewed quarterly and may result in placing the investment manager on the Watch List or terminating an investment manager.¹

Table 2: Quantitative Watch List Criteria for Active Managers

Performance Test²	Fail Criteria	Action Steps
Annualized net performance relative to Market Index for trailing 3 years	Fail if underperform index <i>net</i> of their fees in 8 of 12 previous quarters	Place on Watch List
Annualized net performance relative to Market Index for trailing 5 years	Fail if underperform index <i>net</i> of their fees	Place on Watch List
Annualized gross performance relative to peer group comparison for trailing 3 years	Fail if gross performance is below median in 8 of 12 previous quarters	Place on Watch List, if fails at least one more quantitative measurement
Annualized gross performance relative to peer group comparison for trailing 5 years	Fail if gross performance is below median	Place on Watch List, if fails at least one more quantitative measurement
Annualized net Information Ratio trailing 5 years relative to the agreed upon market index	Fail if the net Information Ratio is below 0.20	Place on Watch List, if fails at least one more quantitative measurement
Annualized gross Information Ratio trailing 5 years relative to the agreed upon market index and peer group	Fail if the gross Information Ratio is below median	Place on Watch List, if fails at least one more quantitative measurement

Table 3: Quantitative Watch List Criteria for Passive Managers

Performance Test³	Benchmark	Action Steps
Annualized net performance relative to Market Index for trailing 3 years	Fail if underperform index <i>net</i> of their fees in 8 of 12 consecutive quarters	Place on Watch List
Annualized net performance relative to Market Index for trailing 5 years	Fail if underperform index <i>net</i> of their fees	Place on Watch List

¹ Quantitative criteria failures will be documented on a quarterly basis, but shall not cause a Watch List determination for one year after inception of a newly-hired manager unless the manager demonstrates underperformance materially inconsistent with the manager’s pre-hire track record and expected risk profile or fails qualitative criteria. Newly-hired managers will be subject to the Section IV processes if Watch Listed, including Retention Reviews, as applicable.

² Upon manager hirings, SBA will collect and maintain at least 5 years of “pre-hire” gross and net of fee performance data for implementation of these Guidelines. The quantitative criteria will become individually applicable as data availability accommodates; e.g., 3 year criteria apply as soon as 3 years of combined pre-hire and SBA-live history is available. Also, see Note 1 for other criteria specifically applicable to newly-hired managers.

³ See Note 1.

IV. Formal Review Process

When a manager is placed on the Watch List, the SBA, with the assistance of the Consultant, will conduct a formal manager evaluation. The evaluation includes the following steps:

1. A letter to the manager stating the reasons for being placed on the Watch List consistent with these guidelines
2. An analysis of recent transactions, holdings and portfolio characteristics to determine the cause of underperformance and/or verify a change in style
3. A Retention Review may be conducted on a manager, although under no circumstance shall a manager be on Watch List for more than 4 quarters without a Retention Review
4. A review of other viable investment alternatives to identify other product providers in the event the firm or product is subsequently terminated

The purpose of a Retention Review is to provide independent and expert input to the SBA's decision to retain or terminate the manager. A Retention Review is a thorough, in-depth due diligence effort, similar in scope and focus to the SBA's initial manager selection process. A Retention Review explores all elements of a manager's performance, organization, personnel, and investment philosophy and process. The Retention Review will focus on whether the investment manager currently embodies characteristics sufficient to provide reasonable assurance that SBA's investment objectives will be achieved in the future. Table 4 contains relative weightings of qualitative and past performance categories to be applied by the Consultant in conducting Retention Reviews.

In addition to the thorough, in-depth due diligence effort, the Retention Review report will include:

1. Recommendation to retain or terminate the manager
2. Detailed rationale for the recommendation
3. If a recommendation is made to retain the manager, identification of key issues which should be closely monitored going forward
4. If a recommendation is made to terminate the manager, alternative action(s) will be suggested for redeploying the portfolio's assets

Unless otherwise agreed, Retention Reviews will be completed within 45 days of initiation.

Table 4: Weighting of Qualitative and Past Performance Categories

Category	Weighting
<i>Qualitative</i>	75.0%
Organization	15.0%
Information	15.0%
Forecasting	15.0%
Portfolio Construction	15.0%
Implementation	7.5%
Attribution	7.5%
<i>Past Performance</i>	25.0%
<i>Total</i>	100%