

840 CMR 1.00: PROTECTION OF INTERESTS OF RETIREMENT SYSTEM MEMBERS AND THEIR BENEFICIARIES

Section

1.01: Board Members' Duty

1.02: Liability for Breach of Fiduciary Duty

1.03: Prohibition Against Certain Persons Holding Certain Positions

These rules to protect the interests of retirement system members and their beneficiaries are promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, ss. 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission, or by statute, these rules protect the interests of retirement system members and their beneficiaries.

1.01: Board Members' Duty

A board member shall discharge all of his/her duties solely in the interest of members and their beneficiaries, and

- (1) For the exclusive purpose of:
 - (a) providing benefits to members and their beneficiaries; and
 - (b) defraying reasonable expenses of administering the system.
- (2) With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.
- (3) By diversifying the investments of the system so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
- (4) In accordance with the Massachusetts General Laws, the rules and regulations promulgated by the Commission, and rules and regulations adopted by the Board and approved by the Commission.

1.02: Liability For Breach of Fiduciary Duty

- (1) Failure to comply with the fiduciary standard set forth in c.32, s.23 and in these regulations may subject the fiduciary to personal liability for any losses to the system resulting from such failure.
- (2) If a fiduciary knowingly participates in, or knowingly conceals, an act or omission of a co-fiduciary which is a breach of fiduciary duty, the fiduciary may be subject to personal liability for any losses to the system resulting from such breach.

- (3) If, by failing to comply with his/her fiduciary duty, a fiduciary enables a co-fiduciary to breach his/her fiduciary duty, the fiduciary may be subject to personal liability for any losses to the system resulting from such breach.
- (4) If a fiduciary has knowledge of a breach of fiduciary duty by a co-fiduciary and the fiduciary fails to make reasonable efforts under the circumstances to remedy the breach of fiduciary duty, the fiduciary may be subject to personal liability for any losses to the system resulting from such breach.

1.03: Prohibition Against Certain Persons Holding Certain Positions

No natural person, business, partnership, corporation, union, committee, club, or other organization, entity or group of individuals that has been convicted of robbery, bribery, extortion, embezzlement, fraud, grand larceny, any crime described in Section 9(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-9(a)(1)), a violation of Section 302 of the Labor-Management Relations Act, 1947 (29 U.S.C. 186), a violation of Chapter 63 of Title 18, United States Code, a violation of Section 874, 1027, 1503, 1505, 1506, 1510, 1951, or 1954 of Title 18 United States Code, a violation of the Labor-Management Reporting and Disclosure Act of 1959 (29 U.S.C. 401), any felony involving abuse or misuse of such person's position or employment in a labor organization or employee benefit plan to seek or obtain an illegal gain at the expense of the members of the labor organization or the beneficiaries of the employee benefit plan, or conspiracy to commit any such crimes, or a crime in which any of the foregoing is an element or has been found by the Commission or any court to have violated his/her fiduciary duty or has been found by the Ethics Commission or any court to have violated M.G.L. c. 268A, shall serve or be permitted to serve:

- (1) As a member, administrator, fiduciary, officer, trustee, custodian, counsel, agent, employee or representative in any capacity of a retirement board.
- (2) As a consultant, manager or provider of goods or services to a retirement board.
- (3) In any capacity that involves decision making authority or custody or control of the monies, funds, assets or property of any system.
- (4) The Commission may, at its discretion, provide for a limit on the period of time that the prohibitions set forth in (1), (2), and (3) apply and the service or role which is prohibited.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

840 CMR 4.00: FINANCIAL OPERATIONS/STANDARD METHOD OF ACCOUNTING

Section

- 4.01: Ledger Accounts, Cash Book and Journal
- 4.02: Entries and Posting of Accounts; Trial Balance
- 4.03: Copies to be Sent to PERAC
- 4.04: Failure to File Financial Reports
- 4.05 Valuation of Holdings

These rules establishing standard methods of accounting for retirement boards are promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, s. 21. Except as may otherwise be provided by the Commission, or by the supplementary rules of a particular retirement board approved by the Commission, or by statute, these rules shall govern methods of accounting of all retirement boards.

4.01: Ledger Accounts, Cash Book and Journal

Every retirement board shall establish, number and maintain ledger accounts in the form prescribed by the Commission and shall maintain a cash book, the format of which shall be provided or approved by the Commission, and a journal for adjusting entries.

4.02: Entries and Posting of Accounts; Trial Balance

- (1) Entries shall be entered on a daily basis.
- (2) The cash book and journal shall be posted to the ledger accounts monthly.
- (3) A trial balance shall be prepared monthly.

4.03: Copies to be Sent to PERAC

- (1) Within four (4) weeks of the close of each month, after all entries for the month have been posted and a trial balance prepared, any retirement board responsible for all assets of the system shall send to the Commission a photocopy of the following for the month:
 - (a) cash book entries;
 - (b) trial balance; and
 - (c) journal entries.
- (2) The retirement board shall send or have sent to the Commission a copy of all custodian statements received by the retirement board within four (4) weeks of the close of the month. Such statements shall be separated into the following five categories: cash, short term investments*, fixed income investments, equities, and pooled funds. Such statements shall include, but not be limited to:
 - (a) monthly custodian bank statements which detail transaction activity including investment income, investments purchased, accrued interest paid, investments sold, book value of

investments sold, profit/loss on investments sold, accrued interest sold, cusip numbers, name of brokers and commissions paid, trade receivables and payables, trade dates, settlement dates and actual settlement dates.

- (b) monthly account appraisal which provides an alphabetical listing of assets held for each category; information for each asset should include a complete description of the asset, cusip numbers, par value or number of shares, book value and market value.

*Short term investments are defined as U.S. Treasury Bills, Commercial Paper, Certificates of Deposit, Repurchase Agreements, Cooperative Shares, Savings and Loan Shares, Money Market Accounts and Term Deposits.

- (3) The retirement board shall send or have sent to the Commission a copy of all statements received by the retirement board within four (4) weeks of the close of the month. Such statements shall detail the activity of the retirement system including purchases and sales of fund shares, income, dividend re-investments, fund expenses, and ownership interest of the retirement system in any commingled funds, including, but not limited to, separate accounts, bank pooled funds, mutual funds, group trusts and limited partnerships.

4.04: Failure to File Financial Reports

Any retirement board failing to file the financial statements and reports required by M.G.L. c. 32, s. 20(5)(g), or by 840 CMR 4.03 shall be subject to the penalties provided by subdivision 2 of M.G.L. c. 32, s. 24(2) and to revocation of acknowledgement(s) granted pursuant to these regulations.

4.05: Valuation of Holdings

All custodians, consultants, investment managers, and other entities providing investment related services to retirement boards shall, under the pains and penalties of perjury, annually certify to the retirement board and the Commission the manner and methods by which the custodian, consultant, investment manager and other entity establishes the value of the holdings of the portfolio account the value of which is reported to the retirement board by the custodian, consultant, investment manager and other entity.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

840 CMR 16.00: INVESTMENT ADVICE AND MANAGEMENT

Section

- 16.01: Definition
- 16.02: Employment of Investment Manager and Investment Consultant When Permitted or Required; Delegation of Responsibility; Expenses; Contract
- 16.03: Use of Custodian Banks; Nominees; Securities Depository
- 16.04: Use of Brokers
- 16.05: Review of Investment Performance; Mandate Modifications
- 16.06: Procurement of Products and Services
- 16.07: Notice to Cease and Desist

These are the standard rules for investment advice and management promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, ss. 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission, or by statute, these rules shall govern investment advice and management provided to any retirement board in the Commonwealth.

16.01: Definition

Unless a different meaning is plainly required by the context, words and phrases used in 840 CMR 16.00 through 25.00, inclusive, shall have the meanings assigned them by 840 CMR 16.01. If no meaning is assigned by this section they shall have the meanings assigned them by M.G.L. c. 32 and if no meaning is so assigned, they shall have their ordinary meanings.

- (1) Person means an individual, partnership, joint venture, corporation, association, trust or, estate
- (2) Investment manager means a person employed by any board to advise the board on the purchase and sale of investments and includes partnerships, trusts and other legal entities established for that purpose.

16.02: Employment of Investment Manager and Investment Consultant; When Permitted or Required; Delegation of Responsibility; Expenses; Contract

- (1) No investment of funds shall take place until board has received from the commission an acknowledgement of receipt of the following:-
 - (a) a certification that, in making the selection, the board has complied with the process established in 16.08;
 - (b) a copy of the vendor certification required 16.08(7);
 - (c) copies of disclosure forms submitted by the selected vendor;
 - (d) a certification that the investment is not a prohibited investment as set forth in 840 CMR 20.01;

- (e) in the event that the board has retained a consultant, a copy of the consultant reports pertaining to the investment and the selected vendor;
- (f) a copy of the board certification required under 16.08(8);
- (g) filings required pursuant to 19.00.

The commission may withhold the acknowledgement if it determines that it is in the best interest of the retirement system provided, however, that it must so notify the board within ten days of receipt of completed documents as required by this section.

- (2) Prior to the retention of an investment consultant the board must receive from the commission an acknowledgement of receipt of the following:-
 - (a) a certification that, in making the selection, the board has complied with the process established in 16.08;
 - (b) a copy of the vendor certification required 16.08(7);
 - (c) copies of disclosure forms submitted by the selected consultant;
 - (d) a copy of the board certification required under 16.08(8);
 - (e) a copy of the registration of the investment consultant as an investment adviser pursuant to the Investment Advisers Act of 1946 (15 U.S.C. 80B-1 et seq.);
 - (f) filings required pursuant to 19.00

The commission may withhold the acknowledgement if it determines that it is in the best interest of the retirement system provided, however, that it must so notify the board within ten days of receipt of completed documents as required by this section.

- (3) The issuance of an acknowledgement letter by the commission is limited to an acknowledgement of the receipt of the items listed in (1) (a) through (g) and (2) (a) through (f) above. Such a letter, absent additional provisions pertaining to supplementary regulations, does not authorize a board to enter into an agreement that allows a manager to deviate from the regulations set forth herein.
- (4) No retirement board which has not received an acknowledgement pursuant to 840 CMR 19.00 may delegate responsibility for the investment of the funds of the system provided, however, that any such board may participate in or purchase units of the PRIT Fund.
- (5) All investment managers shall annually submit a current Form ADV Part II of the Uniform Application for Investment Adviser Registration to the retirement board for which it manages assets and to the Commission.
- (6) If the Commission has reason to believe that a board which has received an acknowledgement pursuant to 840 CMR 16.02, or the investments of any board, do not comply with the requirements of M.G.L. c. 32, s. 23(2), or with the requirements of these regulations, the Commission may require the retirement board to show cause why the acknowledgement should not be revoked. If the retirement board fails to establish that its investments do so comply, the Commission may revoke the acknowledgement.

16.03: Use of Custodian Banks; Nominees; Securities Depository

- (1) Every retirement board shall designate one or more banks or trust companies, organized under the laws of the Commonwealth or of the United States, custodian of the securities and assets of the system, and shall designate as members of any nominee holding securities of the system any authorized employee of such custodian. All assets of the system shall be held by the custodian on behalf of the board. Each retirement board shall direct its custodian to provide the Commission with the reports and information required pursuant to 840 CMR 4.00 and if possible, said reports and information shall be provided by electronic means or electronic access granted to the Commission.
- (2) Any retirement board may authorize a custodian designated pursuant to 840 CMR 16.04 (1) to place the securities of the system in a securities depository registered with the Securities and Exchange Commission for the purpose of facilitating security trading and certificate delivery.
- (3) Retirement boards that invest only in commingled or pooled investment funds may conclude that a full-service custodian bank is not necessary or cost-effective in such circumstances. Such boards may request an exemption from paragraph (1) by stating their capacity to perform record-keeping, cash management, and other functions done by a custodian bank in house or through an alternative source. The Commission will also consider requests from boards seeking authorization to utilize a custodian bank for some but not all of their investment assets.

16.04: Use of Brokers

- (1) Retirement system board members and employees shall not:
 - (a) direct brokerage commissions for services, or
 - (b) instruct its investment manager or managers to direct brokerage commissions.
- (2) Retirement boards shall review brokerage practices and trading costs at least annually with all equity and fixed income managers. Boards shall instruct managers that trades are to be done on the basis of best price and execution and that managers are to provide confirmation of this practice to the board. The manager shall inform the board about the use of “soft dollars”, if any, in the board account. The board shall examine trading to determine if the level of trading within the account appears excessive or unusually high.

16.05: Review of Investment Performance; Mandate Modifications

- (1) Every retirement board shall at least quarterly review the performance of the overall portfolio and selected components against the retirement system's investment goals and policies.
- (2) Every retirement board shall meet with its investment manager or managers at least annually and shall, at a minimum:

- (a) require its investment manager or managers to provide a comprehensive written quarterly report which includes a review of investment performance including a review of the investment manager's relative performance, a review of the system's investments, and a report on the investment manager's current investment outlook or forecast as well as strategy for the future;
 - (b) review each such report in depth with its investment manager or managers; and
 - (c) require its investment manager or managers to send one such report to the Commission each year.
- (3) Every retirement board which has retained an investment manager shall at least annually make a determination as to whether the manager continues to operate in the manner represented when retained and outlined in the agreement between the board and the investment manager.
- (4) Every retirement board which has retained an investment manager shall require said manager to report key personnel staffing changes to the retirement board and the on or before the effective date of such changes.
- (5) PERAC will consider and evaluate requests for such modifications or adjustments to a Board's mandate with an existing manager on an individual basis.

In obtaining approval for such modifications to a current investment contract, a retirement board should submit a request for a supplementary regulation relative to the normal procurement process for an investment-related service. This request should address and provide documentation for the following questions and issues:

- (1) how the proposed modification fits in under the board's investment objectives and strategies,
- (2) the nature of the board's relationship with the investment manager, including length of the existing contract, investment performance over time relative to existing benchmarks, and the overall quality of client service,
- (3) the investment manager's staffing and performance record in the market segment(s) covered by the new mandate, and
- (4) whether a new benchmark for performance has been or should be selected for the portfolio.

Requests for a modification in mandate should generally involve investments within the same broad asset class and should not involve any substantive deviations from the manager's basic investment style. Contracts governing the relationship should be amended to reflect the change(s).

This regulation does not permit major changes to an investment mandate, such as giving a manager hired for growth stocks authority to add a value stock mandate or allowing a manager with a large-cap equity mandate to add small caps. For such major changes in mandate, new competitive processes are still required.

16.06: Procurement of Products and Services

In the procurement of all products and services retirement board members shall comply with the fiduciary duty set forth in chapter 32 section 23 and in 840 CMR 1.00.

In a contract for the procurement of investment, custodial, auditing, actuarial, legal and accounting services, in addition to complying with that fiduciary duty, retirement board members shall comply with the provisions of this regulation.

(1) As used in this section the following words shall, unless the context requires otherwise, have the following meanings:--

"Contract", all types of agreement for the procurement of services, regardless of what the parties may call the agreement.

"Contractor", a person having a contract with the retirement board.

"Retirement board", a board established under the provisions of this chapter thirty – two or, the provisions of chapter thirty – four B .

"Majority vote", as to any action by or on behalf of a retirement board, a simple majority of the board.

"Minor informalities", minor deviations, insignificant mistakes, and matters of form rather than substance of the proposal, or contract document which can be waived or corrected without prejudice to other offerors, potential offerors, or the retirement board.

"Person", any natural person, business, partnership, corporation, union, committee, club, or other organization, entity or group of individuals.

"Procurement", acquiring a service, and all functions that pertain to the obtaining of a service, including description of requirements, selection and solicitation of sources, preparation and award of contract, and all phases of contract administration.

"Proposal", a written offer to provide a service at a stated price submitted in response to a request for proposals.

"Purchase description", the words used in a solicitation to describe the services to be purchased, including specifications attached to or incorporated by reference into the solicitation.

"Request for proposals", the documents utilized for soliciting proposals, including documents attached or incorporated by reference.

"Responsible bidder or offeror", a person who has the capability to perform fully the contract requirements, and the integrity and reliability which assures good faith performance.

"Responsive bidder or offeror", a person who has submitted a bid or proposal which conforms in all respects to the request for proposals.

"Services", the furnishing of labor, time, or effort by a contractor, not involving the furnishing of a specific end product other than reports. This term shall not include employment agreements, collective bargaining agreements, or grant agreements.

- (2) A retirement board shall enter into procurement contracts for investment, actuarial, legal and accounting services utilizing competitive sealed proposals, in accordance with the provisions of this section.
- (3) A retirement board that awards a contract shall maintain a file on each such contract and shall include in such file a copy of all written documents required by this section. Written documents required by this section shall be retained by the retirement board for at least six years from the date of final payment under the contract.
- (4) The retirement board shall give public notice of the request for proposals a reasonable time prior to the date for the opening of proposals. The notice shall:
 - (1) indicate where, when and for how long the request for proposal may be obtained;
 - (2) describe the service desired, and reserve the right of the retirement board to reject any or all bids;
 - (3) remain posted, for at least two weeks, in a conspicuous place in or near the offices of the retirement board until the time specified in the request for proposals; and
 - (4) be published at least once, not less than two weeks prior to the time specified for the receipt of proposals, in a newspaper of general circulation within the area served by the retirement board and in the case of a procurement for investment, custodial, accounting, actuarial or legal services in a publication of interest to those engaged in providing such services.
 - (a) The retirement board shall also place the notice in any publication established by the state secretary for the advertisement of such procurements.
 - (b) The retirement board may distribute copies of the notice to prospective bidders, and may compile and maintain lists of prospective bidders to which notices may be sent.
 - (c) The retirement board shall unconditionally accept a proposal without alteration or correction, except as provided in this paragraph. A bidder may correct, modify, or withdraw a proposal by written notice received in the office designated in the request for proposals prior to the time and date set for the proposal opening. After proposal opening, a bidder may not change the price or any other provision of the proposal in a manner prejudicial to the interests of the retirement board or fair competition. The retirement board shall waive minor informalities or allow the bidder to correct them. If a mistake and the intended proposal are clearly evident on the face of the proposal document, the procurement officer shall correct the mistake to reflect the intended correct proposal and so notify the bidder in writing, and the bidder may not withdraw the proposal. A bidder may withdraw a proposal if a mistake is clearly evident on the face of the proposal document but the intended correct proposal is not similarly evident.
 - (d) The retirement board shall solicit proposals through a request for proposals. The request for proposals shall include:
 - (1) the time and date for receipt of proposals, the address of the office to which the proposals are to be delivered, the maximum time for proposal acceptance by the retirement board;

- (2) the purchase description and all evaluation criteria that will be utilized pursuant to paragraph (d); and
- (3) all contractual terms and conditions applicable to the procurement provided that the contract may incorporate by reference a plan submitted by the selected offeror for providing the required services.

The request for proposals may incorporate documents by reference; provided, however, that the request for proposals specifies where prospective offerors may obtain the documents. The retirement board shall make copies of the request for proposals available to all persons on an equal basis.

- (e) The retirement board shall not open the proposals publicly, but shall open them in the presence of one or more witnesses at the time specified in the request for proposals. Notwithstanding the provisions of section seven of chapter four, until the completion of the evaluations, or until the time for acceptance specified in the request for proposals, whichever occurs earlier, the contents of the proposals shall remain confidential and shall not be disclosed to competing offerors. At the opening of proposals the retirement board shall prepare a register of proposals which shall include the name of each offeror and the number of modifications, if any, received. The register of proposals shall be open for public inspection.
- (f) The retirement board shall be responsible for the evaluation of the proposals. The retirement board shall prepare their evaluations based solely on the criteria set forth in the request for proposals. The evaluations shall specify in writing:
 - (1) for each evaluation criterion, a rating of each proposal as highly advantageous, advantageous, not advantageous, or unacceptable, and the reasons for the rating;
 - (2) a composite rating for each proposal, and the reasons for the rating; and
 - (3) revisions, if any, to each proposed plan for providing the required services which should be obtained by negotiation prior to awarding the contract to the offeror of the proposal.
- (g) The retirement board shall determine the most advantageous proposal from a responsible and responsive offeror taking into consideration price and the evaluation criteria set forth in the request for proposals. The retirement board shall award the contract by written notice to the selected offeror within the time for acceptance specified in the request for proposals. The parties may extend the time for acceptance by mutual agreement. The retirement board may condition an award on successful negotiation of the revisions specified in the evaluation, and shall explain in writing the reasons for omitting any such revision from a plan incorporated by reference in the contract.
- (h) In the event of a competitive process to select an investment service provider the request for proposals shall include mandatory contractual terms and conditions to be incorporated into the contract including provisions required under 840 CMR 19.00, provisions stating that the contractor is a fiduciary with respect to the funds which the contractor invests on behalf of the retirement board, provisions stating that the contractor shall not be indemnified by the retirement board, provisions requiring the contractor to annually inform the commission and the board of any arrangements in

oral or in writing, for compensation or other benefit received or expected to be received by the contractor or a related person from others in connection with the contractor's services to the retirement board or any other client, provisions requiring the contractor to annually disclose to the commission and the retirement board any compensation, in whatever form, paid or expected to be paid, directly or indirectly, by the contractor or a related person to others in relation to the contractor's services to the retirement board or any other client, and provisions requiring the contractor to annually disclose to the commission and the retirement board in writing any conflict of interest the contractor may have that could reasonably be expected to impair the contractor's ability to render unbiased and objective services to the retirement board. Other mandatory contractual terms and conditions shall address investment objectives, brokerage practices, proxy voting and tender offer exercise procedures, terms of employment, fees and termination provisions provided that in a contract for investment consulting services fee schedules shall not be based on a percentage of assets but shall be based on a fixed dollar amount based on services provided. The retirement board shall make a preliminary determination of the most advantageous proposal from a responsible and responsive offeror taking into consideration price and the evaluation criteria set forth in the request for proposals. The retirement board may negotiate all terms of the contract not deemed mandatory or non-negotiable with such offeror. If, after negotiation with such offeror, the retirement board determines that it is in the best interests of the retirement board, the retirement board may determine the proposal which is the next most advantageous proposal from a responsible and responsive offeror taking into consideration price and the evaluation criteria set forth in the request for proposals, and may negotiate all terms of the contract with such offeror. The retirement board shall award the contract to the most advantageous proposal from a responsible and responsive offeror taking into consideration price, the evaluated criteria set forth in the request for proposals, and the terms of the negotiated contract. The retirement board shall award the contract by written notice to the selected offeror within the time for acceptance specified in the request for proposals. The time for acceptance may be extended for up to 45 days by mutual agreement between the retirement board and the responsible and responsive offeror offering the most advantageous proposal as determined by the retirement board.

On or before January 1 of each year the contractor shall file the disclosures required herein with the board and the commission.

- (5) The retirement board may cancel a request for proposals or may reject in whole or in part any and all proposals when the retirement board determines that cancellation or rejection serves the best interests of the system. The retirement board shall state in writing the reason for a cancellation or rejection.
- (6) A person submitting a proposal for the procurement or disposal of services to any retirement board shall certify in writing on the proposal as follows:

The undersigned certifies under penalties of perjury that this proposal has been made and submitted in good faith and without collusion or fraud with any other person. As used in this

certification, the word "person" shall mean any natural person, business, partnership, corporation, union, committee, club, or other organization, entity, or group of individuals.

(Signature of individual submitting bid or proposal)

(Name of business)

(7) Each retirement board member shall certify to the commission in writing with respect to a procurement subject to the provisions of this section, as follows:

The undersigned certifies under penalties of perjury that this selection has been made in good faith and without collusion or fraud with any other person. As used in this certification, the word "person" shall mean any natural person, business, partnership, corporation, union, committee, club, or other organization, entity, or group of individuals.

(Signature of individual retirement board member)

(Name of retirement board)

(8) No person shall cause or conspire to cause the splitting or division of any request for proposals, proposal, solicitation, or quotation for the purpose of evading a requirement of this section.

(9) Unless otherwise provided by law and subject to paragraph (a), a retirement board may enter into a contract for any period of time which serves the best interests of the retirement board; provided, however, that the retirement board shall include in the solicitation the term of the contract and conditions of renewal, extension or purchase, if any.

(a) A retirement board shall not award a contract for a term exceeding five years, including any renewal, extension, or option provided, however, that a retirement board may participate in a limited partnership, trust or other entity with a term for a period longer than five years as part of an investment of system assets.

When a contract is to contain an option for renewal, extension, or purchase, the solicitation shall include notice of the provision. The retirement board shall retain sole discretion in exercising the option, and no exercise of an option shall be subject to agreement or acceptance by the contractor.

(b) The retirement board shall not exercise an option for renewal, extension or purchase unless the retirement board, after reasonable investigation of costs and benefits, has

determined in writing that the exercise of the option is more advantageous than alternate means of procuring comparable services.

- (10) All specifications shall be written in a manner which describes the requirements to be met without having the effect of exclusively requiring a proprietary service, or procurement from a sole source.
- (11) All contracts shall be in writing, shall be executed prior to the delegation of authority to the vendor and the retirement board shall make no payment for a service rendered prior to the execution of such contract.
 - (a) A contract made in violation of this section shall not be valid, and the retirement board shall make no payment under such contract. Minor informalities shall not require invalidation of a contract.
- (12) A procurement file for each such selection shall be maintained by the board and be subject to audit. Said file shall contain the request for proposals, responses to the request for proposals, selection process, selection criteria and other information relative to the board meeting its fiduciary responsibility with respect to the selection. Documents required by this section shall be retained by the retirement board for at least six years from the date of final payment under the contract.
- (13) Vendors involved in the investment of assets of a retirement system shall notify the retirement board and the Commission in the event that an action is proposed to be taken that would modify the contractual mandate of a manager or other entity investing assets for a retirement board (for example an increase in the foreign exchange trading limits by a counterparty); and in the event of the submission of an inaccurate notification or a failure to notify takes place, the contract or agreement between the vendor and retirement board shall be terminated.
- (14) Notwithstanding the provisions herein in the event that aboard seeks to make a modest modification or adjustment to its mandate with an existing investment manager it may do so with the approval of the Commission. In order to obtain that approval a board shall submit a request for a supplemental regulation relative to the procurement process. The request shall address and provide documentation of the following:
 - (1) how the modification fits in under the board's investment objectives and strategies;
 - (2) the nature of the board's relationship with the investment manager, including length of existing contract, investment performance over time relative to existing benchmarks;
 - (3) the investment manager's staffing and performance record in the market segment(s) covered by the new mandate;
 - (4) whether a new benchmark for performance has been selected for the portfolio.

Requests must involve investments within the same asset class and should not seek substantive deviations from the manager's basic investment style. Contracts must be amended to reflect the change.

16.07: Notice to Cease and Desist

If the Executive Director of the Public Employee Retirement Administration Commission has reason to believe that any person including, without limitation, any board or member or investment manager thereof, has invested or is investing the funds of a system without authorization or in violation of any provision of M.G.L. c. 32, or 840 CMR 16.00 through 25.00, inclusive, the Executive Director shall issue a notice to such person to cease and desist from doing so and, if the Executive Director finds that protection of system funds so require, the Executive Director may:

- (1) remove any such person from advising any retirement system or managing the funds of any system; or
- (2) petition the Superior Court to compel the observance and restrain the violation of any provision of M.G.L. c. 32, s. 23, or 840 CMR 16.00 through 25.00.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

DRAFT

840 CMR 17.00: STANDARDS OF CONDUCT FOR FIDUCIARIES AND INVESTMENT MANAGERS

Section

17.01: Bonding of Persons Having Access to Retirement Board Funds

17.02: Standards of Conduct for Fiduciaries

17.03: Standards of Conduct for Investment Managers and Consultants

These rules establishing standards of conduct for fiduciaries and qualified investment managers are promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, ss. 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission, or by statute, these rules shall govern the conduct of all retirement board fiduciaries and investment managers. No person who is not a investment manager as defined by 840 CMR 16.01(2) shall provide investment advice on the purchase and sale of investments to or manage the funds on behalf of any retirement system.

17.01: Bonding of Persons Having Access to Retirement Board Funds

All retirement board members and retirement system staff shall be bonded in an amount sufficient to provide reasonable protection against losses due to fraud and dishonesty and each shall be bonded for no less than 10% of the amount of the fund or \$500,000. The Commission may prescribe a bond in excess of \$500,000, provided that such bond shall not exceed 10% of the amount of the fund.

17.02: Standards of Conduct for Fiduciaries

Every fiduciary shall know and comply with all applicable provisions of M.G.L. c. 268A governing the conduct of public officials and employees and shall conform to the standards of conduct prescribed by M.G.L. c. 268A, s. 23.

(1) Every fiduciary shall:

- (a) Comply with the standards set forth in 840 CMR 1.00
- (b) operate in accordance with retirement system procedures, documents and instruments;
and
- (c) inform each retirement system investment manager of the Code of Ethics and Standards of Conduct applicable to investment managers pursuant to 840 CMR 17.02 and 17.04.

17.03: Standards of Conduct for Investment Managers and Consultants

In addition to the standards of conduct for fiduciaries and the standards set forth in 840 CMR 1.00 Investment Managers shall comply with these standards of conduct. These standards of conduct shall also apply to Consultants retained pursuant to 840 CMR 25.00.

(1) Compliance with Applicable Law, Regulations, Code of Ethics and Standards of Conduct.

- (a) Knowledge of and Compliance with Applicable Law, etc. Every investment manager and every consultant shall be familiar with and comply with all applicable laws and rules and regulations, including rules and regulations of any self-regulatory agency of the profession, and the standards of conduct of 840 CMR 17.02 and 17.03
 - (b) Assisting Legal and Ethical Violations Prohibited. No investment manager or consultant shall knowingly participate in, or assist any act in violation of any statute or regulation governing securities matters or any act in violation of the standards of conduct of 840 CMR 17.02 and 17.03.
 - (c) Use of Material Non-Public Information Prohibited. Every investment manager and every consultant shall comply with all laws and regulations relating to the use of material non-public information. No investment manager or consultant shall communicate or take investment action on the basis of such information until it is publicly disseminated and any investment manager or consultant who acquires such information, other than as a result of a special or confidential relationship with an issuer, shall make reasonable efforts to achieve public dissemination of such information by the issuer.
- (2) Supervision of Employees. Every investment manager and every consultant shall exercise reasonable supervision over employees and agents subject to his or her control to prevent violation by such persons of applicable statutes, regulations, and the standards of conduct of 840 CMR 17.02 and 17.03.
- (3) Misrepresentation Prohibited. No investment manager or consultant shall make any statement, orally or in writing, which materially misrepresents the services that the investment manager or consultant is capable of performing for the board, the qualifications of the investment manager or consultant, the investment performance that the investment manager has achieved or can be expected to achieve for the board or the expected performance of any investment. No investment manager or consultant shall make any unsupported statement concerning these matters or any statement, orally or in writing, about any investment which guarantees or conveys any unsupported assurances, explicitly or implicitly.
- (4) Priority of Transactions. Every investment manager and consultant shall conduct himself or herself in such a manner that transactions for the retirement board have priority over personal transactions, and that personal transactions do not operate adversely to the board's interest. An investment manager making a recommendation about the purchase or sale of a security shall give the board adequate opportunity to act on the recommendation before acting on the investment manager's own behalf.
- (5) Disclosure of Conflicts.
- (a) Every investment manager, and every consultant when making an investment recommendation or taking an investment action, shall disclose to the retirement board and the Commission in writing any conflict of interest the investment manager or consultant may have and any beneficial ownership of the securities involved which could reasonably be expected to impair the investment manager's or consultant's ability to render unbiased and objective advice.

- (b) Every investment manager, and every consultant shall disclose to the board and the Commission in writing all matters which could reasonably appear to interfere with the investment manager's or consultant's duty to the board or ability to render unbiased and objective advice.
- (c) Every investment manager, and every consultant shall also comply with all requirements as to disclosure of conflicts of interest imposed by law and by rules and regulations of organizations governing the activities of investment advisors and shall comply with any prohibition of such activities if a conflict of interest exists.

(6) Compensation Disclosure

- (a) Every custodian, consultant, investment manager and other vendor shall, under the pains and penalties of perjury, annually disclose to the retirement board and the Commission any and all compensation that to their knowledge has been, is being or will be paid, in whatever form and to whatever party that relates in any way to the services provided to the retirement board and, in the event that the submission of an inaccurate disclosure or a failure to disclose takes place, the contract or other agreement between the vendor and the retirement board and all other retirement boards shall be terminated;
- (b) In the event that a vendor or prospective vendor provides compensation in whatever form to another party for services that either directly or indirectly relate to said vendor providing or seeking to provide services to a retirement board, said vendor or prospective vendor shall cause said party to disclose, under the pains and penalties of perjury, to the retirement board and the Commission, any and all compensation that to their knowledge has been, is being or will be paid by that party, in whatever form and to whatever party, that relates in any way to the services that party provides to said vendor, and, in the event that the submission of an inaccurate disclosure or a failure to disclose takes place, the contract or other agreement between the vendor and the retirement board and all other retirement boards shall be terminated;
- (c) Every custodian, consultant, investment manager and other vendor shall, under the pains and penalties of perjury, annually disclose to the retirement board and the Commission the identity of any and all individuals that have been involved in anyway with the services provided to the retirement board whether or not the custodian, consultant, investment manager and other vendor has knowledge of compensation, if any, provided to that individual

(7) Enforcement and Liability.

- (a) Every investment manager and every consultant shall be deemed to have agreed with the retirement board:
 - 1. to be liable to the board for any losses due to any violation of the provisions of M.G.L. c. 32, s. 23 or of these regulations, including without limitation, any violation of the code of ethics of 840 CMR 17.02 or the standards of conduct of 840 CMR 17.03 and 17.04;
 - 2. to be subject to removal as a investment manager or consultant by the Commission in the event that the Commission determines that the investment manager or consultant has violated any of the provisions of M.G.L. c. 32, s. 23 or of these regulations,

including, without limitation, any provision of the code of ethics of 840 CMR 17.02 or the standards of conduct of 840 CMR 17.03 and 17.04; and

3. that neither the board nor the Commission shall be liable to the investment manager or consultant for any such loss, by way of indemnity or otherwise, or for any such removal.

(b) No investment manager or consultant removed by the Commission pursuant to 840 CMR 17.04(10)(a)2 shall continue to serve or be employed as a investment manager or as a consultant by any other retirement board except as may otherwise be authorized by the Commission.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

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840 CMR 18.00 Placement Agents

- 18.01: Definitions
- 18.02: Manager Responsibilities
- 18.03: Board Responsibilities
- 18.04: Penalties
- 18.05: Contract Terms
- 18.06: Campaign Contributions
- 18.07: Effective Date
- 18.08: Statement of Intent

These rules to regulate the activities of third party placement agents are promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s.50 and M.G.L. c. 32, §.21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board, or by statute, these rules regulate the activities of third party placement agents.

18.01: Definitions

The following words and phrases as used in this regulation, unless a different meaning is plainly required by context, shall have the following meanings:-

“Manager”, investment partners with whom retirement boards do business, including, but not limited to, general partners, investment managers, sponsors of hedge funds, private equity funds, real estate funds, infrastructure funds and any entity to which a retirement board delegates discretionary investment authority.

“Placement agent”, any person or entity hired, employed, engaged, retained by or acting on behalf of or otherwise receiving remuneration from a manager or another placement agent as a finder, solicitor, marketer, consultant broker or other intermediary in relation to the investment of assets of Massachusetts public pension systems, including any person or entity which provides proactive consultant services concerning the changing political and policy environment in New England and nationally as it relates to retirement plans, notwithstanding the description of such services as informational consulting services only not involving the referral of investment advisory services, provided, however, this regulation shall not apply with respect to in house employees of managers.

18.02: Manager Responsibilities

- (1) Each manager is responsible for providing the following information to the Board and PERAC in conjunction with responding to an RFP or solicitation, commencing discussions relative to amending an agreement between the manager and the Board or entering into discussion, other than informal, general discussions, that may lead to any of the above referenced actions.
 - a. a statement whether the manager or any principal, employee, agent or affiliate has compensated or agreed to compensate, directly or indirectly any person or entity to act as

- a placement agent in connection with investment by the Massachusetts public pension systems;
- b. a resume for each placement agent detailing the person's education, professional designations, regulatory licenses and investment and work experience. If any such person is a current or former member of a retirement board, employee or consultant or immediate family of such a person that fact should be specifically noted;
- c. a description of any and all compensation of any kind provided or agreed to be provided to a placement agent and/or entity acting as a placement agent in connection with investment by Massachusetts' public pension systems, including the nature, timing and value thereof;
- d. a description of the services to be performed by the placement agent and/or entity acting as a placement agent and a statement as to whether the placement agent is used by the manager with all prospective clients or only a subset of clients or only Massachusetts public pension fund clients;
- e. a written copy of any and all agreements between the manager and the placement agent and/or entity acting as a placement agent in connection with investment by Massachusetts' public pension systems;
- f. in the event that any current or former Massachusetts public pension system Board members, employees, consultants or other service providers have suggested the retention of the placement agent, the names of any current or former Massachusetts public pension system Board members, employees, consultants or other service providers who suggested the retention of the placement agent;
- g. a statement that the placement agent has a minimum of three years experience in the investment field; and,
- h. a statement that the placement agent and/or entity acting as a placement agent is registered with the Securities and Exchange Commission or the Financial Industry Regulatory Authority, or, if appropriate, the Commodity Futures Trading Commission and the details of such registration.

18.03: Board Responsibilities

- (1) The Retirement Board is responsible for providing the following to managers and prospective managers:
 - a. a copy of this policy and appropriate PERAC forms as part of the selection process for investment or engagement;
 - b. a copy of this policy and appropriate PERAC forms at the time discussions are initiated with respect to amendment of agreements or other actions noted above;
 - c. reviewing placement agent and/or entity acting as a placement agent information disclosures, in detail, as part of the due diligence process;
 - d. compiling an annual report containing the names and amount of compensation agreed to be provided to each placement agent and/or entity acting as a placement agent by each manager as reported in the placement agent information disclosures and disclosing the report to the public by posting on the board website and/or posting in a readily accessible site at the retirement board offices;
 - e. reporting to PERAC any material violations of this policy as soon as practicable after discovery of such violations.

18.04: Penalties

- (1) PERAC shall withhold regulatory approvals and acknowledgments if:
 - a. the placement agent and/or entity acting as a placement agent information disclosure or other information reveals that the placement agent and/or entity acting as a placement agent that the manager has used is not registered with the Securities and Exchange Commission or the Financial Industry Regulatory Authority or, if appropriate, the Commodity Futures Trading Commission; or,
 - b. the placement agent and/or entity acting as a placement agent information disclosure or other information reveals that the placement agent does not possess three years experience in the investment field.
- (2) PERAC shall prohibit any manager or placement agent from soliciting new investments from any retirement board for a period to be determined by the Commission after the manager or placement agent has committed a material violation of this regulation.

18.05: Contract Terms

- (1) Each contract and amendment to an existing contract as of 10/1/11 shall secure the agreement of the manager in the final written agreement between the retirement board and the manager to provide the retirement board with the following remedies in the event the manager knew or should have known of any material inaccuracy or omission in the placement agent information disclosure or any other violation of this policy:
 - a. whichever is greater, the reimbursement of any management or advisory fees paid by the retirement board for the prior two years or an amount equal to the amounts paid or promised to be paid to the placement agent as a result of the retirement board investment;
 - b. the authority to immediately terminate the investment management contract or other agreement with the manager without penalty, to withdraw without penalty from a limited partnership, limited liability company or other investment vehicle, or to cease making further capital contributions (and paying any fees on these recalled commitments) to the limited partnership, limited liability company or other investment vehicle without penalty; and,
 - c. provisions requiring the manager to annually inform PERAC and the board of any arrangements in oral or in writing, for compensation or other benefit received or expected to be received by the manager or a related person from others in connection with the managers services to the retirement board or any other client, provisions requiring the manager to annually disclose to PERAC and the retirement board any compensation, in whatever form, paid or expected to be paid, directly or indirectly, by the manager or a related person to others in relation to the managers' services to the retirement board or any other client, and provisions requiring the manager to annually disclose to PERAC and the retirement board in writing any conflict of interest the manager may have that could reasonably be expected to impair the manager's ability to render unbiased and objective services to the retirement board.

Each contract and amendment to an existing contract as of 10/1/11 shall secure the agreement of the manager in the final written agreement between the retirement board and the manager that the manager shall be solely responsible for, and the retirement board shall not pay (directly or indirectly), any fees, compensation or expenses for any placement agent used by the manager.

18.06: Campaign Contributions

(1) Candidates for Board membership shall disclose to the Board and the Commission the names of those who have contributed who are active in the investment field, including placement agents, and the amounts of campaign contributions made to the candidate relating to the member's campaign as Treasurer, if applicable, or his campaign to become a member of the Board.

18.07: Effective Date

This regulation applies to all agreements with managers entered into after 10/1/11 or agreements to amend existing agreements made after that date (including by vote, consent or waiver by limited partners/investors or a subset of the limited partners/investors or separate side agreement or agreement to amend a side agreement) to continue, terminate or extend the term of the agreement or investment period, increase the commitment of funds by the pension system or increase or accelerate the fees or compensation payable to the manager.

18.08: Statement of Intent

In promulgating these regulations PERAC is not endorsing or discouraging the use of placement agents.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

840 CMR 19.00 Hedge Funds

- 19.01: Hedge Funds Definition
- 19.02: Retirement Board Investment
- 19.03: Limits on Allocation
- 19.04 Diversification
- 19.05 Hedge Fund Strategies
- 19.06 Selection Process
- 19.07 Reporting

840 CMR 19.00, regulating the investment in hedge funds, is promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c.7 S.50 and M.G.L. c.32 SS 21 and 23. except as may be otherwise provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, 840 CMR 19.00 shall govern the investment of retirement boards in hedge funds.

19.01 Hedge Funds Definition

The term “hedge funds” generally refers to unregulated investment products that seek absolute returns through the use of specialized investment strategies that are expected to have low correlation to the major financial markets. Products that involve strategies basically similar to those of traditional active management approaches will not be approved. Retirement systems seeking to invest in hedge funds should incorporate this sector into their long-term asset allocation plan.

19.02 Retirement Board Investment

- (1) Retirement boards with investment assets in excess of \$150 million, at the time of request, may request authorization to conduct a search for hedge fund of funds.
- (2) The Commission will consider requests from retirement boards with assets below \$150 million on a case by case basis and the Commission will consider, among other factors, the retirement board’s overall performance record, its experience in alternative asset classes, the level of expertise utilized by the board, and the clarity and strength of its written submission.
- (3) The Commission may deny any retirement board the authority to invest in Hedge Funds if circumstances warrant.

19.03 Limits on Allocation

- (1) Total investment in hedge funds, based on market valuation at the time of investment, cannot exceed the existing percentage of the PRIT Core Fund allocated to hedge funds. Qualified boards may invest up to 50% of the maximum allowed allocation to hedge fund products and any amount in excess of 50% of the maximum hedge fund allocation must be invested in the PRIT Hedge Fund segment.

- (2) Retirement boards below the \$150 million asset minimum may invest up to the percentage of portfolio assets established by the PRIT Fund in the PRIT Fund hedge fund segment without PERAC regulatory action.

19.04 Diversification

- (1) Retirement boards that invest on their own must use funds of funds exclusively for their hedge fund investments:
 - (a) Investors in funds of funds should on an ongoing basis receive a current listing that identifies all underlying funds and be kept informed periodically on hedge funds that have been liquidated and/or added to the portfolio.
- (2) Systems that invest on their own shall seek to have a sufficient number of funds of funds so that no single fund of funds represents over 2% of the system's total investment portfolio. Systems must be aware of the extent of overlap in the various funds of funds' holdings of separate hedge funds.
- (3) The total number of separate, underlying hedge funds in a system's total portfolio shall be at least 75. The market value of any single hedge fund held within one or more of a system's fund of funds should not represent more than 2.5% of the market value of the retirement board's total hedge fund portfolio.
- (4) At the time of investment and at any time during the holding period, a particular Massachusetts retirement fund should not represent more than 10% of a hedge fund product's total assets and Massachusetts public funds together should not represent more than 50% of the total assets in the product.

19.05 Hedge Fund Strategies

- (1) Retirement boards must invest in hedge fund products that invest primarily in relative value, non-directional strategies as opposed to strategies where performance is largely influenced by general market movements or by movements in specialized markets like energy or commodities:
 - (a) Hedge fund products should be reasonably diversified among major strategy groups such as equity hedge (long/short equity), relative value and event driven.
 - (b) The R-squared, beta and correlation statistics for the product should indicate that past performance has not been related to or correlated with any of the major financial markets to a significant degree.
 - (c) The product's volatility, as measured by the standard deviation of returns, should not be greater than 7.5% (which means that the performance of the product is expected to be within plus or minus 7.5% of the annualized return about two thirds of the time).
 - (d) These and any related statistics must be included in the retirement board's submission of regulatory documents to PERAC.
 - (e) Retirement boards must understand the extent to which leverage is used in the hedge fund products under consideration. Although it is expected that some hedge fund of funds

structure may employ strategies that use substantial leverage, the effective leverage in the composite product shall not exceed one time existing capital.

- (f) On case by case basis, the PERAC staff, subject to approval of the Commission, will consider the approval of a particular hedge fund of funds that may not be in compliance with one or more of the above restrictions as long as the board's aggregate portfolio of hedge funds of funds is in compliance with the restrictions. In no instance will the Commission approve a hedge fund of funds with fewer than ten constituent funds or volatility greater than 10%.

19.06 Selection Process

- (1) Before beginning a search, the board must submit a letter to PERAC staff summarizing its objectives in investing in hedge funds, discussing how this fits into overall asset allocation, and explaining how its hedge fund investments would be structured in order to accomplish those objectives. In considering whether to authorize a system to conduct a search for hedge funds, PERAC may take into account such factors as the retirement board's past investment performance, the system's funded ratio, and the board's record of compliance with PERAC regulations and guidelines. If the board has not received notice from PERAC within ten business days, it may commence its search process.
- (2) Boards must work with an investment consultant who has experience in analyzing, conducting searches for, and monitoring hedge funds, preferably for institutional clients. For some boards, this may involve retention of a consultant separate from the one it currently uses for traditional asset classes. While using the consultant for educational purposes and for assistance in conducting a search, the retirement board should 1) have a basic understanding of the investment strategies involved; 2) be committed to making final decisions on its own relative to any investment in hedge funds; and, 3) be committed to working with the consultant to closely monitor hedge fund investments
- (3) As is the case with all instances of vendor selection, a fair and open competitive process is required for selection, commencing with the issuance of an RFP:
 - (a) These regulations shall be distributed to potential managers as part of the RFP.
 - (b) Boards need not limit their consideration to firms that respond to the advertised RFP. Proposals may be solicited from firms that the board and its consultant consider to be qualified.
- (4) Boards should work with their consultant to determine various parameters that would govern their search, such as what minimum levels of assets under management or length of investment track records should be applied to prospective fund of funds or other managers. At the minimum, such standards should establish that the firms in question have proven themselves to be going concerns in terms of both asset growth and management capability.
- (5) An appropriate benchmark by which to monitor and evaluate hedge fund performance shall be determined.

- (6) Boards must carefully examine not only the backgrounds of the managers and their investment record but also the firm's business infrastructure and operational capability.
- (7) The retirement board must submit a letter to PERAC which certifies that the hedge fund product was selected as a result of a competitive process (a summary of and timeline for the process should be included). The board shall maintain a complete file containing documents on the major steps (interviews, site visits, reference checks, etc.) included in the due diligence process conducted by the board and its consultant.
- (8) Selected hedge fund product managers will complete PERAC Disclosure Statement and Vendor Certification forms as part of the RFP process:
 - (a) Managers shall state the structure of management fees inherent in the product, managers must disclose any financial arrangements between themselves, consultants, and any other third parties.
 - (b) On an Application for Exemption, managers will submit detailed information to PERAC staff on their key personnel, assets under management, investment strategy, investment process, risk control, organizational structure, performance record, et al.
 - (c) PERAC will refuse to issue regulatory approval for managers it deems to have insufficient or questionable credentials and who fail to meet reasonable standards of experience and capability. The Commission will also deny an application if the process used to select the manager was flawed or where financial arrangements raise concerns regarding the selection process. As with any proposed investment, the Commission may withhold approval of an acknowledgement if it is in the best interests of the retirement system.
- (9) Hedge fund products that have registered with the SEC or another federal agency shall be preferred over those that have not.

19.07 Reporting

- (1) All managers shall transmit quarterly performance and strategy review reports to the board and to PERAC. Reports from fund of funds managers should include information on each constituent fund:
 - (a) The retirement board and its consultant should meet with its fund of funds managers for a performance and strategy review at least once a year.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

840 CMR 20.00: LIST OF PROHIBITED INVESTMENTS

Section

These rules establishing a list of prohibited investments are promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, ss. 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission, or by statute, these rules shall prohibit investments of retirement system funds invested pursuant to M.G.L. c. 32, s. 23, whether or not exempt pursuant to 840 CMR 19.00.

20.01: Prohibited Investments

No investment by any retirement board or by any bank pooled fund, mutual fund, group trust, limited partnership, insurance company separate account or other form of pooled investment of any retirement board shall consist of any of the following:

- (1) Purchases of securities by partial payment of their cost (purchases on margin).
- (2) Sale of securities not owned by the system at the time of sale (short sales), except where short sales are an explicit and essential part of “relative value” trading in certain investment strategies and part of the strategies of individual hedge funds in hedge funds of funds.
- (3) Use of futures and options shall be permitted to the extent their use is part of an explicit and limited strategy. These uses include duration management and liquidity management for fixed income funds, liquidity management and market exposure management in equity funds and for disciplined and controlled currency hedging in international investment products.

Boards shall notify PERAC of the extent of expected use of futures and/or options as part of the regulatory submission for managers and such use shall be explicitly included in the account guidelines or prospectus.

Any use of futures, options, or any other derivative instruments for purposes not consistent with the basic portfolio strategy is prohibited.

- (6) Lettered or restricted stock (with the exception of those investments that are venture capital investments).
- (7) Direct investment in mortgages, not including mortgages and/or mortgage backed securities held in commingled or managed funds or within investment partnerships.
- (8) Collateral loans (with the exception of those investments that are leveraged buyout investments), provided, however that boards may participate in so-called “securities lending” programs through a custodian and provided, further, that the lending of securities is limited to

brokers, dealers, and financial institutions and that the loan is collateralized by cash or United States Government securities according to applicable regulatory requirements.

(9) Loans to employees or individuals.

(10) Direct purchase of real estate, not including real estate held in managed funds or within investment partnerships.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.

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840 CMR 21.00: STANDARD RULES FOR ORDERS TO PROTECT THE SYSTEM

Section

- 21.01: Temporary Orders
- 21.02: Investigations and Hearings
- 21.03: Findings of Fact
- 21.04: Permanent Orders

These are the standard rules for orders to protect the system and investigations and hearings related thereto promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, s. 50 and M.G.L. c. 32, ss. 21 and 23(4). Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, these are the standard rules for orders to protect the system and the conduct of investigative hearings to determine whether the investment and recordkeeping practices of any retirement board are being conducted with reasonable care, skill, prudence or diligence pursuant to M.G.L. c. 32, s. 23(4).

21.01: Temporary Orders

The Commission, upon reasonable belief that the practices of any retirement board are not being conducted with reasonable care, skill, prudence or diligence, may order such retirement board to take or cease from taking any action that in its judgment is necessary to protect the integrity of the retirement system. Any such order issued by the Commission shall remain in effect until such time as an investigation, hearing and finding of fact can be made pursuant to the provisions of 840 CMR 22.00 and M.G.L. c. 32, s. 23(4). Violation of such orders shall be punishable as provided in M.G.L. c. 32, s. 24.

21.02: Investigations and Hearings

- (1) Investigations; Requests for Information. The Commission, upon reasonable belief of improprieties in the practices of any retirement system, may initiate an investigation of such practices. In connection with such investigation the Commission may require the retirement board to provide information which may be deemed relevant thereto. Any such information contained in any document, paper, correspondence or other record maintained by the retirement board shall be provided to the Commission upon request. Any findings of fact made by the Commission or a designee pursuant to 840 CMR 26.03 shall reflect evidence obtained from such information as well as evidence presented at a hearing conducted pursuant to 840 CMR 26.02(2).
- (2) Purpose of Hearings; Notice Requirements. In cases where the Commission has issued a temporary order pursuant to M.G.L. c. 32, s. 23(4) and 840 CMR 26.01, an investigative hearing may be convened within sixty (60) days thereafter. In all other cases the Commission may convene such hearing at any time; but in no case shall the retirement board whose practices are under investigation be given less than thirty (30) days prior notice of such hearing. The purpose of such investigative hearing shall be to determine whether the

practices of the retirement board are being conducted with reasonable care, skill, prudence or diligence. The notice of hearing shall set forth the retirement board practice(s) under investigation and outline the procedures to be followed in such hearing.

- (3) Parties, Procedures for Hearings. Upon notice from the Commission to any retirement board that an investigative hearing is to be held pursuant to 840 CMR 26.02(2), such retirement board personnel as are named in the notice shall appear to represent the retirement board before the Commission or a designee on the date specified therein. The Commission may also require parties not affiliated with the retirement board to appear at such hearing, if there is reason to believe that such party has influenced the practices of the retirement board. The procedures to be followed in such investigative hearing shall be subject to the discretion of the Commission. Any retirement board or party who is requested to appear may be represented by counsel. Such parties shall be allowed to present evidence as to the propriety of the practice under investigation.

21.03: Findings of Fact

At the conclusion of the investigation conducted pursuant to M.G.L. c. 32, s. 23(4) and 840 CMR 26.02, the Commission or a designee shall make such findings of fact as are warranted from the evidence collected during the course of the investigation and at the hearing. Such findings of fact shall be made in writing and a copy thereof shall be delivered to the retirement board, any other party requested to appear at the hearing and their counsel. Any permanent order to the retirement board to take or cease from taking any action shall be based upon such findings of fact.

21.04: Permanent Orders

After having conducted an investigation and hearing pursuant to M.G.L. c. 32, s. 23(4) and 840 CMR 26.02 and making such findings of fact as are warranted by the evidence collected during the course of such investigation and hearing, the Commission may order the subject retirement board to take or desist from taking any action that in its judgment is necessary to preserve the integrity of the system. No such order shall obtain unless the Commission may reasonably conclude from such findings of fact that the practices of the retirement board are not being conducted with reasonable care, skill, prudence or diligence. Violation of such order shall be punished as provided for in M.G.L. c. 32, s. 24.

REGULATORY AUTHORITY

840 CMR 1.00: M.G.L. c. 7, s. 50; M.G.L. c. 32, ss. 21 and 23.