

James R. Wilbanks, Ph.D.  
Retirement Administrator



Telephone: (707) 463-4328  
(707) 467-6473  
Fax: (707) 467-6472

**MENDOCINO COUNTY**  
EMPLOYEES' RETIREMENT ASSOCIATION  
625-B KINGS COURT  
UKIAH, CALIFORNIA 95482-5027

Date: March 18, 2015  
To: Board of Retirement  
From: James Wilbanks, Retirement Administrator  
Subject: Investment Policy Statement Amendment – Investment Manager Watchlist

Below is draft language regarding Investment Manager Termination and Watchlist for your consideration. This language was drafted by Callan, with some minor edits on my part. Based on survey of other funds, my experience and the attached email from Greg Ungerman, I recommend the Board **not** adopt the following as part of the Investment Policy Statement.

**DRAFT INVESTMENT POLICY STATEMENT AMENDMENT**  
**Criteria for Investment Manager Termination and Watchlist**

MCERA reserves the unilateral right to terminate a manager at any time for any reason. The occurrence of certain events will result in specific actions being taken. It also establishes a “Watchlist” as a means of monitoring and evaluating managers who meet any of the items identified under the “Criteria For Investment Manager Termination”. Each manager on the Watchlist will be monitored closely by Staff and the Consultant and may be required to make special presentations to the Board and Staff if requested. When it is deemed warranted due to improved conditions, a manager may be removed from the Watchlist.

The Watchlist criteria can be a multitude of this including but not limited to:

- Illegal or Unethical Practice.
- Deviation from Investment Process.
- Loss of Key Personnel or Change in Ownership.
- Lack of Cooperation with Reasonable Requests.
- Underperformance. MCERA understands the cyclical nature of investment performance and the potential for its investment managers not to meet objectives over short-term periods. While it is not the Board’s intention to terminate a manager for short-term underperformance relative to objectives, the Board has implemented the following process as a means of monitoring and evaluating managers that have experienced performance difficulties in the short-term.

If a manager trails its relevant benchmark and/or ranks well below median in its peer universe for two consecutive years, the manager will be placed on the Watchlist. If the underperformance of a manager on the Watchlist persists over a reasonable period in the future (as defined by the Staff, Board and Consultant based on the unique circumstances surrounding the manager and current market conditions), the Board may and will consider termination.

**From:** Greg Ungerman <ungerman@callan.com>  
**To:** James Wilbanks <wilbanksj@co.mendocino.ca.us>  
**CC:** "Stan Conwell (conwells@co.mendocino.ca.us)" <conwells@co.mendocino.ca.us>, Greg DeForrest <deforrest@callan.com>, "Alina Vartanyan" <vartanyan@callan.com>  
**Date:** 3/6/2015 2:45 PM  
**Subject:** Draft Watchlist for Board Consideration  
**Attachments:** WatchlistPolicyDraft.docx

Hello James,

Per our discussion last week, we have put together a draft for a formal "Watchlist" policy as the Board requested during the February meeting. It identifies some of the key criteria we use as an industry best practice on a qualitative and quantitative basis in the evaluation of investment managers and their investment funds. It is also important to recognize that there may be many additional factors that could warrant the watchlist sentiment but not apparent what they may be at this time. The spirit of the watchlist is meant to be a way to identify and outwardly communicate what funds are failing to achieve certain minimum criteria that is below expectations but not so drastic as to warrant immediate termination.

In our view, we already do this for all of your funds in the Plan, whether you have a watchlist or not. From Callan's perspective, we do not require a watchlist and consider every one of your funds and their investment organizations on watch at all times. We believe your fiduciary obligation does not change in monitoring or remaining vigilant in fund oversight. In our experience, watchlists can become a distraction and receive a disproportionate amount of time and attention. In addition, if the watchlist policy is too formulaic, Boards often feel obligated to take termination action too soon and sell the strategy at the bottom because of the perceived risk when a fund is on the watchlist. But it really does depend on why the fund or organization is on the watchlist to begin with.

While a watchlist is not needed for our purposes, we do recognize that some organizations report out to other participants, Boards, and/or stakeholders so the idea of a watchlist is helpful in communicating out that there is displeasure with those on the list but some expectation the issues will improve, otherwise action will be taken.

Happy to discuss further.

Greg T. Ungerman, CFA  
Senior Vice President  
Fund Sponsor Consulting

Callan Associates Inc.  
600 Montgomery Street  
Suite 800  
San Francisco, CA 94111

Information contained herein is the confidential and proprietary information of Callan and should not be used other than by the intended recipient for its intended purpose or disseminated to any other person without Callan's permission.