

**Alameda County Employees'
Retirement Association**

ACERA

DIRECTED BROKERAGE POLICY

Amended May 22, 2008

ACERA DIRECTED BROKERAGE POLICY

TABLE OF CONTENTS

I.	SCOPE	3
II.	PURPOSE	3
III.	LEGAL AUTHORITY	3
IV.	BEST EXECUTION	3
V.	DIRECTED BROKERAGE	4
VI.	STRATEGIC OBJECTIVE AND GOALS	4
VII.	ROLES AND RESPONSIBILITIES	4
VIII.	DETERMINING INVESTMENT MANAGER PARTICIPATION AND TARGET PERCENTAGE OF DIRECTION	7
IX.	MONITORING AND REPORTING	9
X.	QUALIFICATIONS OF CORRESPONDENT BROKERS	9
XI.	APPLICATIONS OF RECAPTURED COMMISSION DOLLARS	10
APPENDIX I	List of Directed Brokerage Program Participating Investment Managers And Target Percentage of Direction	11
APPENDIX II	List of Correspondent Brokers	12
APPENDIX III	Reporting Schedule	13
APPENDIX IV	Minimum Qualification Requirements for Correspondent Brokers	14
APPENDIX V	Table of Amendment Dates	15

I. SCOPE

This Directed Brokerage Policy (“DB Policy”) governs the Directed Brokerage Program (“DB Program”) of Alameda County Employees’ Retirement Association (“ACERA”) and applies to the trading activities associated with externally and separately managed assets of ACERA’s Trust Fund (“Fund”). This DB Policy is subject to all provisions of applicable law and to change by the ACERA Board (“Board”). This DB Policy also adheres to the limitations and requirements of ACERA’s General Investment Guidelines, Policies and Procedures under all circumstances pertaining to the affiliated parties. The Board reserves the right to amend, supplement or rescind this DB Policy at any time.

II. PURPOSE

This DB Policy establishes a framework for the use of a DB Program to 1) minimize total transaction costs while seeking “Best Execution” for all transactions and maximizing the value of services received; and 2) provide for proper monitoring and oversight of the Program. This DB Policy also guides the Third-Party Directed Brokerage Administrator, participating investment managers (“Investment Managers”), and investment consultants (“Consultants”) selected by ACERA as well as ACERA’s Investment Staff (“Staff”) to take prudent action in managing the DB Program.

III. LEGAL AUTHORITY

This DB Policy is established in accordance with Article XVI, Section 17 of the California State Constitution, which establishes the fiduciary responsibilities of the Board. The Securities and Exchange Commission (“SEC”), the Internal Revenue Service and the Department of Labor have concluded that commissions are assets of plan sponsors and not investment managers. Therefore, the Board has a fiduciary responsibility to ensure that the DB Program benefits ACERA’s members and beneficiaries through a reduction in explicit and implicit trading costs and to monitor those costs. Staff will use every effort to seek “Best Execution” as defined in the “Best Execution” section below, with respect to all portfolio transactions.

IV. BEST EXECUTION

“Best Execution” is defined to mean the execution of particular investment decisions at a price and commission that provides the most favorable total cost and proceeds reasonably obtainable under all circumstances. ACERA encourages its Investment Managers to use a variety of methods and venues for achieving “Best Execution”. These methods and venues include choosing the best broker for the transaction or possibly bypassing the directed broker entirely. “Best Execution” does not necessarily mean paying the lowest possible commission fee. A brokerage commission is the fee paid to an agent (broker) for services rendered as a sum or percentage of a transaction. The broker facilitates transactions (thereby acting as an intermediary) and may help reduce total transaction costs for a fee or markup in price. A brokerage commission is the explicit portion of the total transaction cost. Brokerage commissions are paid 1) to compensate the intermediary for services rendered via trade

execution; and 2) sometimes to compensate brokerage firms for providing both internally-generated investment research services and independent, externally-generated investment research services. Such compensation is generally known as “soft-dollars.”

V. DIRECTED BROKERAGE

Directed Brokerage (“DB”) generally refers to an arrangement whereby a Plan Sponsor instructs its Investment Managers to send trades to specific brokers, in return for which, the brokers will rebate a portion of the commission and/or provide services to the Plan Sponsor.

ACERA recognizes that commissions are necessary to facilitate the execution of trades and/or the purchase of services. Furthermore, commissions are a part of the execution function of the investment process. DB is a widespread practice among pension plans to recover, recapture and use a portion of commissions to defray expenses which would otherwise have been incurred and paid for with budgeted funds.

VI. STRATEGIC OBJECTIVE AND GOALS

The strategic objective of the DB Program is to take advantage of the industry-accepted recapture of a portion of trade commissions paid to brokers.

The primary goals of the DB Program are to 1) recapture 50% or more of commissions paid on a specific percentage of trades sent to correspondent brokers on a timely basis; 2) construct the percentage of trades subject to recapture so as to allow investment managers to have access to the research they need; 3) seek “Best Execution” through third-party administration oversight and outside consultant monitoring; and 4) encourage local and emerging broker participation through the use of an open correspondent network program.

VII. ROLES AND RESPONSIBILITIES

The delineation of roles and responsibilities is important for efficient and effective management of ACERA’s DB Program. The duties and responsibilities of the Board, Investment Committee, Staff, Third-Party DB Administrator, Consultants, Investment Managers, and brokerage firms in the correspondent network (“Correspondent Brokers”) in relation to the DB Program are stated below:

A. Board

The Board has the responsibility of approving the implementation of the DB Program at ACERA and approving the DB Policy that governs the DB Program. The Board, with consultation from the Investment Committee, shall review the DB Policy annually to determine whether modifications are necessary.

B. Investment Committee

The Investment Committee shall monitor compliance of ACERA's DB Program with the DB Policy as set forth in this document. It shall evaluate proposals for modification, as needed, and make recommendations for consideration by the Board. The Investment Committee shall review the DB Policy on an annual basis.

C. Staff

Staff is responsible for establishing appropriate procedural documentation. In addition, Staff:

1. Develops and maintains specific procedures, if necessary, to comply with the approved DB Policy;
2. Develops and recommends changes to the DB Policy;
3. Implements the DB Policy;
4. Publicizes the availability of the DB Program in the local area;
5. Monitors the DB Program to ensure compliance with the DB Policy;
6. Submits DB reports to the Investment Committee periodically;
7. Reports to the Investment Committee all violations of the DB Policy with explanations and recommendations;
8. Monitors additions or deletions of Correspondent Brokers in the correspondent network;
9. Monitors the execution quality of Correspondent Brokers; and
10. Encourages greater participation by all Correspondent Brokers by assisting Investment Managers, as needed, to increase their directed trades to the upper limit of their recommended target percentages of direction while maintaining "Best Execution."

D. Third-Party DB Administrator

The Third-Party DB Administrator hired by the Board is responsible for implementing, administrating and monitoring ACERA's DB Program so as to ensure compliance with ACERA's DB Policy. Specific responsibilities of the Third-Party DB Administrator for ACERA include, but are not limited to:

1. Executing directed trades through internal and correspondent trading desks;
2. Reconciling these trades with the underlying Investment Managers in a timely manner;
3. Providing monthly and quarterly reports to ACERA (see Appendix II);
4. Transferring recaptured commissions to ACERA monthly for all prior month's DB trading activities in a timely manner;
5. Informing Staff and Investment Managers of additions/deletions of Correspondent Brokers in the correspondent network;
6. Monitoring all Correspondent Brokers to ensure they meet all the qualifications listed in Section X of the DB Policy;

7. Monitoring the execution quality of Correspondent Brokers;
8. Encouraging greater participation by all Correspondent Brokers by assisting Investment Managers, as needed, to increase their directed trades to the upper limit of their recommended target percentages of direction while maintaining “Best Execution;” and
9. Attending meetings as needed.

E. Consultants

1. Transaction Cost Consultant (TC Consultant)

The TC Consultant hired by the Board is responsible for continuous monitoring and analysis of the efficiency of ACERA’s DB Program. The TC Consultant assists Staff in crafting the DB Policy and implementing the DB Program and is responsible for the ongoing transaction cost monitoring of ACERA's externally-managed equity portfolios. The TC Consultant is also responsible for monitoring the trading practices surrounding the DB Program, in particular:

- a. Monitoring Investment Manager compliance with Fund guidelines and objectives as set forth in ACERA’s General Investment Guidelines, Policies and Procedures;
- b. Implementing the DB Program and ensuring that it remains consistent with the precepts of "Best Execution";
- c. Monitoring and comparing execution quality of DB trades with non-directed trades;
- d. Assisting Staff to monitor the DB Program to ensure compliance with the DB Policy;
- e. Conducting follow-up meetings with underperforming Investment Managers on an as needed basis and reporting the results back to Staff;
- f. Monitoring the execution quality of Correspondent Brokers;
- g. Recommending target percentages of direction to Investment Managers; and
- h. Attending meetings as needed.

2. General Investment Consultant (GI Consultant)

The GI Consultant hired by the Board shall continuously monitor and analyze the effectiveness and efficiency of ACERA’s DB Program and make related recommendations, if necessary, in order to serve the best interest of the plan participants. The GI Consultant also assists Staff in implementing the DB Program and crafting the DB Policy.

F. Investment Managers

Investment Managers are fiduciaries and should conduct all their trading activities in the best interest of ACERA and its members. Investment Managers shall abide by all ACERA's policies and procedures, and fully comply with appropriate regulatory agencies. Investment Managers shall:

1. Ensure that all securities transactions in ACERA's account are consistent with their obligation to seek "Best Execution;"
2. Work closely with the Third-Party DB Administrator, Staff, and Consultants to provide support, data, and reports in a timely manner;
3. Provide feedback, if any, to the Third-Party DB Administrator and Staff on additions/deletions of Correspondent Brokers in the correspondent network;
4. Choose Correspondent Brokers that will seek "Best Execution" and the lowest cost considering all of the factors involved; and
5. Use best efforts to meet the pre-determined target percentage of direction.

The List of DB Program Participating Investment Managers and Target Percentage of Direction is attached hereto as Appendix I.

G. Correspondent Brokers

Correspondent Brokers have an obligation to seek "Best Execution" on each and every trade. Correspondent Brokers are expected to reconcile trading activity with each Investment Manager and the Third-Party DB Administrator. Based on the various correspondent brokerage agreements with the Third-Party DB Administrator, Correspondent Brokers will be required to credit the Third-Party DB Administrator for all directed trading commissions minus the agreed upon execution charge. A list of Correspondent Brokers participating in ACERA's DB Program is attached hereto as Appendix II. This list is created and revised regularly by the Third-Party DB Administrator.

VIII. DETERMINING INVESTMENT MANAGER PARTICIPATION AND TARGET PERCENTAGE OF DIRECTION

In determining Investment Manager participation and the target percentage of direction of each participating Investment Manager, Staff, with its Consultants, shall evaluate the Investment Manager using the factors described below. Appendix I attached to this DB Policy reflects the result of the evaluation.

A. Ability to Achieve Best Execution

The ability of an Investment Manager to achieve "Best Execution" is the most important factor in determining Investment Manager participation. The costs associated with executing a trade are both implicit and explicit. The explicit costs are the commission costs associated with administering trades (brokerage charge, stamp-tax, SEC charge, etc.). Implicit costs

are market impact costs and opportunity costs. The implicit costs are not transparent to a fund and are difficult to measure and monitor on an ongoing basis.

B. Investment Manager's Investment Style

An Investment Manager's investment style may or may not lend itself to DB without jeopardizing "Best Execution." For example, value managers are generally better suited for direction than growth managers. Value managers often emphasize a sensitivity to relative price (value), overlaid with securities earnings growth potential. As a result, value managers often purchase stocks as prices are flat or falling, and sell stocks as prices are peaking or still rising, making it "easier" to trade at desired price levels by providing liquidity to the market. Conversely, growth managers' stock selections often support the market consensus as regards to earnings and/or Price/Earning ratios. As a result, growth managers' trades often compete with those of other market participants who are "running-up" prices, making it more "difficult" to trade at desired price levels.

C. Principal Trades or Large Program Trades

Some Investment Managers' trading strategies are not suited to directing commissions. These include but are not limited to: 1) Investment Managers that execute a large number of principal trades and program trades; and 2) Investment Managers that trade certain types of securities such as: a) those that trade on less liquid international exchanges, b) domestic small cap securities, c) emerging markets, and d) other thinly traded or relatively illiquid stocks.

D. Investment Manager's Assets Under Management (AUM)

Boutique firms, or new firms whose total AUM may be low, will most likely be less able to participate in ACERA's DB Program. As a result of low AUM, these firms' low trade volumes do not fulfill most brokers' economies of scale, therefore it is important that they pay full commission to ensure adequate coverage and "Best Execution."

E. External Research

For some Investment Managers, the research received from brokers or paid through soft dollar arrangements with specific brokers is critical to their investment process. In some cases, the Investment Manager should not be forced to direct commissions since it may cannibalize the source of funds used to pay for research which is critical to its ability to meet performance objectives. If an Investment Manager does not utilize street research, it is more capable of directing a portion of its commissions for ACERA's benefit.

F. Investment Manager's Level of Participation

If an Investment Manager is not directing brokerage for other clients and is forced to do so, there is a risk of disrupting its trading style and process. Forcing an Investment Manager that does not direct trades for others to direct trades on behalf of ACERA is potentially detrimental to ACERA's trading execution because other clients' trades will likely be placed first in the queue to be executed. As a result, ACERA trades would be placed later, leading to less than desirable execution quality since the market will likely have been impacted by the first trade, and/or be subject to the opportunity costs associated with this delay.

IX. MONITORING AND REPORTING

ACERA's Third-Party DB Administrator, Consultants and Staff will closely monitor and analyze the DB Program to facilitate effectiveness while seeking "Best Execution."

ACERA's Third-Party DB Administrator, Investment Managers and Consultants will be required to submit all reports to Staff in accordance with Appendix III – Reporting Schedule.

Staff, in conjunction with Third-Party DB Administrator and Consultants will perform comprehensive evaluations of ACERA's DB Program annually, and will report the findings to the Investment Committee.

X. QUALIFICATION OF CORRESPONDENT BROKERS

ACERA encourages all participating Investment Managers to utilize all the Correspondent Brokers, especially local and emerging Correspondent Brokers when such utilization does not compromise "Best Execution." ACERA also encourages local or emerging brokers to participate in its DB Program and will publicize the program locally.

To qualify under ACERA's DB Program, a broker shall annually establish to the satisfaction of ACERA that it currently meets, and for the preceding twelve (12) months has continuously met, the following minimum requirements:

- a. It is a registered broker under the Securities Exchange Act of 1934;
- b. It possesses the ability to provide "Best Execution" as determined by Investment Managers and the Third-Party DB Administrator; and
- c. It meets the minimum requirements of the Third-Party DB Administrator for inclusion of a broker into its correspondent network.

The Minimum Qualification Requirements for Correspondent Brokers of ACERA's Third-Party DB Administrator is attached hereto as Appendix IV.

XI. APPLICATIONS OF RECAPTURED COMMISSION DOLLARS

The Third-Party DB Administrator shall wire recaptured commission dollars (refund) on a monthly basis in accordance with the instructions provided to the Third-Party DB Administrator by the Fund. These refunds will be used exclusively for the benefit of the Fund and in no event will be used to pay any expenses that would otherwise be paid by any other Fund, or by any other party.

Appendix I

List of Directed Brokerage Program Participating Investment Managers and Target Percentage of Direction*

Investment Manager	Style	Target Percentage
AQR	International Quantitative	Up to 10%
Brandywine	Small Cap Value	Up to 15%
Capital Guardian	International Core/Growth	Up to 20%
Mondrian	International Value	Up to 15%
NCG	Small Cap Growth	Up to 10%
NCG	Micro Cap Growth	Up to 10%
Pzena	Large Cap Value	Up to 25%
Salus	Large Cap Core	Up to 20%
TCW	Large Cap Growth	Up to 10%

*Recommended by Plexus Plan Sponsor Group, Inc. based on its study of ACERA's investment portfolio and subject to change after additional evaluation by Plexus and adoption by the ACERA Board.

Appendix II

List of Correspondent Brokers*

B-Trade Services
Bear Stearns Securities
Bley Investment Group
Cabrera Capital Markets
Capital Institutional Services, Inc.
Exane BNP Paribas (non-USD)
Finacorp Securities
Heflin & Co., LLC
HSBC (US and Asia/Pacific)
Imperial Capital
Instinet LLC
JPMorgan (U.S.)
Knight Securities
LAM Securities
Magna Securities
Merrill Lynch (U.S.)
Northeast Securities
Pershing & Co.
Piper Jaffray & Co.
Pulse Trading
Robert Van Securities
SG Cowen Securities
Societe Generale
State Street Global Markets (Europe)
WJB Capital

* Provided by the Third-Party DB Administrator – CAPIS as of 3/31/08.

Appendix III

Reporting Schedule

<u>Monthly</u>	<u>Due Date</u>	<u>Source</u>
Directed Brokerage Statement	20 days after month-end	Third-Party DB Administrator (CAPIS)
Directed Trade Report	20 days after month-end	Investment Managers
 <u>Quarterly</u>		
Commission Recapture and Brokerage Allocation Report	30 days after quarter-end	Third-Party DB Administrator (CAPIS)
Execution Analysis Report	30 days after quarter-end	Third-Party DB Administrator (CAPIS)
Directed % Analysis	30 days after quarter-end	TC Consultant (Plexus)
Quarterly DB Report	30 days after quarter-end	TC Consultant (Plexus)
 <u>Annually</u>		
Annual DB Program Report and Analysis	60 days after year-end	Third-Party DB Administrator (CAPIS) and TC Consultant (Plexus)
Annual DB Memo (as necessary)	90 days after year-end	GI Consultant (SIS)

Appendix IV

Minimum Qualification Requirements for Correspondent Brokers

ACERA's Third-Party DB Administrator's (Capital Institutional Services (CAPIS)) minimum qualification requirements for adding brokers to their Global Trading Network include but are not limited to the following*:

- Executing Broker is registered with the Securities and Exchange Commission ("SEC") as a broker-dealer and engages in the business of providing securities and investment services to customers.
- The parties do not intend that a joint venture, partnership, agency or other relationship be created as between them.
- No party, nor their respective employees, shall be deemed employees or agents of, or co-venturers with, any other party by virtue of having entered into an agreement. No party has the capacity or authority to make commitments for or on behalf of the other and may not make any representation regarding the relationship between or among the parties without the prior written consent of the affected party.
- Nothing in an agreement limits any party's ability to enter into similar or different arrangements with other parties or otherwise freely conduct their business.

*Minimum qualification requirements may be amended by CAPIS from time to time when appropriate.

Appendix V

Table of Amendment Dates

May 18, 2006

May 22, 2008