

**Alameda County Employees'
Retirement Association**

ACERA

DIRECTED BROKERAGE POLICY

Amended November 20, 2014

ACERA DIRECTED BROKERAGE POLICY

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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 subject to change by the ACERA Board (“Board”) from time-to-time. This DB Policy is subject to the limitations and requirements of ACERA’s General Investment Guidelines, Policies and Procedures under all circumstances. 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 implementation 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 DB Program. This DB Policy establishes guidelines for the Third-Party Directed Brokerage Administrator, 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. Parties subject to these guidelines shall 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 strategies for achieving “Best Execution”. These methods and strategies include choosing the appropriate 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, analysis and other transaction services and independent, externally-generated investment research services. Such compensation is generally known as “soft-dollars.”¹

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 or for the benefit of 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 that 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 practice of recapturing 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) identify a target percentage range of trades that may be subject to commission recapture 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 broker² and/or emerging broker³ 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:

¹ All Investment Managers shall conduct soft dollar and directed brokerage arrangements in accordance with (a) Section 28(e) of the Securities Exchange Act of 1934, as amended (Section 28(e)) and (b) California Government Code Sections 6930, *et seq.*

² A local broker is defined as any broker that (1) maintains an office in the Greater San Francisco Bay Area, including, without limitation, Alameda County; or, (2) employs a minimum of two employees within the Greater San Francisco Bay Area, including, without limitation, Alameda County.

³ An emerging broker is defined as any broker that generated total, firm-wide commissions during the prior calendar year, by equity trading activities in all markets, no greater than \$25 million.

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 recommendations from the Investment Committee, shall review the DB Policy at least every three years or as needed to determine whether modifications are necessary.

B. Investment Committee

The Investment Committee shall monitor ACERA's DB Program to ensure compliance 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 at least every three years or as needed.

C. Staff

Staff is responsible for establishing appropriate procedural controls, and implementing and adhering to the DB Policy. In doing so, Staff is responsible for:

1. Developing and maintaining specific procedures, if necessary, to comply with the approved DB Policy;
2. Developing, reviewing, and recommending changes to the DB Policy as needed;
3. Implementing the DB Policy;
4. Publicizing the availability of the DB Program in the local area;
5. Monitoring the DB Program to ensure compliance with the DB Policy;
6. Submitting DB reports to the Investment Committee quarterly;
7. Reporting to the Investment Committee all violations of the DB Policy with explanations and recommendations;
8. Monitoring additions or deletions of Correspondent Brokers in the correspondent network (also known as the Global Trading Network or "GTN") maintained by Capital Institutional Services (CAPIS);
9. Monitoring the execution quality of Correspondent Brokers;
10. 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
11. Updating Appendix I – List of Directed Brokerage Program Participating Investment Managers and Target Percentage of Direction, and Appendix II – List of Correspondent Brokers, as needed.

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 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 commission dollars to ACERA monthly for all prior months' DB trading activities in a timely manner;
5. Informing Staff and Investment Managers of additions/deletions of Correspondent Brokers in the correspondent network on at least a calendar quarterly basis;
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. Providing ACERA's Transaction Cost Consultant with relevant data to enable reconciliation and analysis of trading and recaptured commissions. Such data transmissions will occur no later than two weeks after the receipt of all relevant and necessary data has been obtained by the Third-Party DB Administrator;
9. 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
10. 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 specifically related to transaction costs 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 underperforming⁴ Investment Managers on an as needed basis and reporting the results back to Staff;
- f. Monitoring the execution quality of Correspondent Brokers;

⁴ "Underperforming" refers to managers whose transactions costs are greater than average on a consistent basis.

- 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 shall conduct all their trading activities in the best interest of ACERA, its members, and beneficiaries. Investment Managers shall abide by all ACERA's policies and procedures, and comply fully with all applicable statutes and regulations. Investment Managers are responsible for:

1. Ensuring that all securities transactions in ACERA's account are consistent with their obligation to seek "Best Execution", as provided herein;
2. Working closely with the Third-Party DB Administrator, Staff, and Consultants to provide support, data, and reports in a timely manner;
3. Providing feedback, if any, to the Third-Party DB Administrator and Staff on additions/deletions of Correspondent Brokers in the correspondent network;
4. Choosing Correspondent Brokers that will seek "Best Execution" and the lowest cost considering all of the factors involved; and
5. Using 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. Pursuant to a written correspondent brokerage agreement with the Third-Party DB Administrator, Correspondent Brokers shall 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 easily identified 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/Earnings 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 and processes 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; 2) Investment Managers that trade at discount commission rates and that allocate portions of their commission budgets to soft dollars; and 3) 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 expectations; 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 expectations. 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 at least every three years or as needed, and will report the findings and recommendations to the Investment Committee. Annually, Staff will review the DB Program to determine whether the four goals (listed on page 4, Section VI) have been met and perform a cost-benefit analysis on the DB Program. Please refer to the Appendix III – Reporting Schedule for responsibilities that are assigned to ACERA's Third-Party DB Administrator, Consultants, and Staff.

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 and/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 and the Third-Party DB Administrator 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 set forth on Appendix IV – Minimum Qualification Requirements for Correspondent Brokers.

XI. APPLICATION 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 Direction⁵

Investment Manager	Style	Target Percentage
Bivium		
Bivium – Cupps	All Cap – Growth	Up to 20%
Bivium-Cornerstone	All Cap – Growth	Up to 30%
Bivium-Lombardia	All Cap – Value	Up to 30%
Bivium – Vulcan Value	All Cap – Value	Up to 30%
Capital Guardian	International - Core/Growth	Up to 10%
Kennedy Capital Management	Small Cap - Value	Up to 10%
NCG	Small Cap - Growth	Up to 10%
NCG	Micro Cap - Growth	Up to 10%
Pzena	Large Cap - Value	Up to 30%
TCW	Large Cap - Growth	Up to 25%

⁵ Recommended by Zeno Consulting Group LLC, (formerly, Plexus Plan Sponsor Group, Inc.)(Zeno) based on its study of ACERA's investment portfolio and subject to change after additional evaluation. Zeno recommends excluding OakBrook and Phocas (both Bivium managers) from direction since they trade at discount rates. In addition, Zeno recommends excluding Nichols (Bivium manager) from direction owing to the lack of available trading data.

Appendix II

List of Correspondent Brokers⁶

B. Riley & Co.
Barclays (US Algo and DMA only)
BIDS Trading
Blaylock Robert Van, LLC
Bley Investment Group
Cabrera Capital Markets
Capital Institutional Services, Inc.
CF Global Trading
Commission Direct, Inc.
Cowen Securities (U.S.)
Heflin & Co., LLC
HSBC (U.S. and Asia/Pacific)
ICAP (U.S.)
Imperial Capital
Instinet, LLC
ITG, Inc.
Knight Securities
Kota Global Securities
LAM Securities
Liquidnet
O'Neil Securities
Merrill Lynch (U.S.)
Northeast Securities
Pershing, LLC
Piper Jaffray & Co.

Societe Generale
State Street Global Markets (Europe)
Weeden & Co LP

⁶ Provided by the Third-Party DB Administrator – CAPIS as of 9/30/2014.

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 (Zeno)
Quarterly DB Report	30 days after quarter-end	TC Consultant (Zeno)
 <u>Annually</u>		
DB Program Memo	60 days after year-end	TC Consultant (Zeno)
DB Program Memo	60 days after year-end	Third-Party DB Administrator (CAPIS)
DB Program Memo	90 days after year-end	GI Consultant (SIS)
Memo on the four DB Program goals	90 days after year-end	Staff
Cost-Benefit Analysis	90 days after year-end	Staff

Appendix IV

Minimum Qualification Requirements for Correspondent Brokers⁷

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 following⁸:

- 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.

⁷ CAPIS requires that any request to add a brokerage firm to the qualified list (Appendix II) originate from any active Investment Manager. CAPIS has granted ACERA the option to request brokers be added to the Correspondent Broker list. However, Staff will not seek to influence CAPIS' decision to place a broker on its list in any way.

⁸ These requirements were provided by CAPIS and may be amended by the same from time-to-time when appropriate.

Appendix V

Table of Amendment Dates

May 18, 2006
May 22, 2008
September 16, 2010
September 15, 2011
November 20, 2014