

## MEMORANDUM

To: Tim Nguyen, Interim CIO, ERSRI

Date: March 17, 2017

From: Pension Consulting Alliance, LLC

Re: **CPC Platform Manager RFI Process and Recommendation**

---

The following memo summarizes the platform manager (Dedicated Managed Account Platform) RFI process and manager recommendation of RI investment staff and PCA.

### **Executive Summary:**

The Employees Retirement System of Rhode Island ("ERSRI") strategic policy allocation to the Crisis Protection Class ("CPC") is 8% of plan assets (approximately \$600 million). The class is designed to offset large negative returns in the portfolio growth asset portfolio. The class is composed of a 50/50 allocation to long-duration U.S. Treasury securities and systematic trend following strategies.

PCA in consultation with the Rhode Island investment staff issued a Request for Information ("RFI") for platform management services to six firms. After an initial review and rating of the technical proposals, the Man FRM and Aberdeen / HedgeMark proposals were highly rated and were evaluated in greater detail. In addition to reviewing each firm's technical proposal and fees, on-site manager due diligence meetings were conducted at each. After a detailed RFI evaluation process and review of proposers' best and final fee offers, the Rhode Island investment staff and PCA **recommend the Rhode Island SIC hire Aberdeen / HedgeMark as the CPC portfolio platform manager.**

### **Background:**

The CPC portfolio is composed of two investment strategies, long-duration U.S. Treasuries and systematic trend following strategies. Both strategies can experience return volatility under various market conditions which should be managed consistent with the class' role and investment objectives. As a result, management of the total CPC portfolio will benefit from a platform manager to oversee portfolio risk management, policy compliance and rebalancing, as well as other administrative / reporting functions.

### **Platform Manager Functions:**

Responsibilities of the platform manager include: Intra-class rebalancing, cash collateral management and transfer, investment manager operational due diligence, strategy

guideline monitoring, risk measurement, risk monitoring, risk and performance reporting services and client service – interface with the Rhode Island investment staff.

**Manager RFI Review Process:**

PCA distributed RFI documents to the following six investment firms on January 6, 2017. All six firm were believed to be capable providers of platform management services. The RFI scope of services is included in Appendix A. Proposer minimum requirements (“RMO”) are included in Appendix B.

- Aberdeen / HedgeMark
- Cliffwater / InfraHedge
- Franklin Templeton
- Lyxor Asset Management
- Man FRM Asset Management
- North Star Financial Services Group

The RFI covered the following issues: firm ownership and resources, experience with dedicated managed account platform mandates, client base, client service model and capabilities, personnel tenure with the firm, responsibilities and experience, service management philosophy and process, risk management philosophy and process, analytical tools and reports, client references and fees.

Manager responses were due January 6, 2017. Manager technical proposals were reviewed by the Rhode Island investment staff and PCA. Aberdeen / HedgeMark and Man FRM were the highest rated proposers. Onsite-visits were scheduled with both firms in their New York City offices (Man FRM – February 15, 2017 and Aberdeen / HedgeMark February 16, 2017). In addition to the on-site meetings, several conference calls were conducted with the proposers, the RI investment and legal staffs, and PCA to review account structure design issues.

Both proposers were asked to submit a best and final fee proposal. The proposals were rerated. The Aberdeen / HedgeMark proposal received the highest rating.

**Aberdeen / HedgeMark Overview**

**Investment Services:**

Aberdeen / HedgeMark provides critical data transparency daily and monitors a multiplicity of risks including: onboarding and legal structuring risk, investment risk, counterparty risk, liquidity risk, leverage risk, investment management agreement compliance risk, rebalancing risk, and cash control risk.

Aberdeen provides operational due diligence on managers that the system wishes to employ in order to limit non-investment risks. In addition, Aberdeen can provide advice on manager selection, portfolio construction, rebalancing, and manager monitoring.

**Organizational Overview, Firm Background and Developments:**

Aberdeen Asset Management Inc. (Aberdeen) is a \$400 billion global asset manager with \$30 billion AUM in alternatives. Their platform support capabilities consist of 28 professionals, including seven dedicated risk management professionals and 11 operational due diligence professionals. Aberdeen utilizes HedgeMark to provide platform infrastructure-related services to its managed account clients.

HedgeMark Advisors, LLC (HedgeMark), was founded in 2009 and is currently 100% owned by BNY Mellon. The firm has built out a robust technology platform to service managed accounts. Aberdeen has been developing managed account solutions while leveraging HedgeMark's risk and performance analytics system since 2012, and has established 64 custom managed accounts solutions totaling approximately \$5.2 billion in non-discretionary assets. Aberdeen is HedgeMark's longest standing client.

Recent organizational development: On March 5, 2017, a proposed merger of Aberdeen Asset Management and Standard Life was announced, which the firms anticipate (subject to regulatory approval, and to the approval of the shareholders) will be completed in Q3 2017. The proposed merger would create an investment business with \$790 billion assets under administration of which \$700 billion are assets under management. As it relates to the alternatives solutions business from a U.S. perspective, the potential merger is expected to have little or no impact on the team, their research process or their ability to service clients. Of the two companies, Aberdeen alone has an external alternatives investment presence in the U.S. and is committed to organically growing that business with the current team and infrastructure. While creating some level of uncertainty, the business unit should be reasonably insulated from these corporate level actions to, so as not to impact the contemplated services materially.

**Portfolio Data Processing / Risk Measurement:**

Data collection occurs between 6pm and 9pm EST from Administrator. They conduct data enrichment processing utilizing the Bloomberg security master at 10pm EST, scraping attributes for the data engine in India, and processing all securities through the risk engine (pricing models). The risk and positioning output is checked for reasonableness and reconciled daily. Current positioning is available to look at down to the position level, up to the portfolio level, and on whatever basis is desired. The portfolio risk dashboard can be customized to report or display an almost unlimited variety of metrics, as is desired by the client.

Aberdeen utilizes current exposures, exposure trends, and regression analysis to set expectation parameters (max drawdown, target annualized volatility, bull / bear correlations) in order to evaluate portfolio behavior and advise on such behavior. Once a warning or a violation is triggered relative to parameter expectations, Aberdeen will investigate the violation. This involves discussing with the manager, informing the client, and clearing the violation (“curing the guideline breach”). The triggers for a breach will be created collaboratively with Rhode Island investment staff and PCA. Aberdeen uses Alternative Soft, a returns-based regression software, to analyze potential portfolio changes, generate potential rebalancing trades, and then export them to Excel. These are then provided to a client as a rebalancing recommendation. Daily risk and return attribution is available and can be auto-run and pushed out as a daily report package. The system is seamless, allowing for return analysis, exposure reports, risk calculation, and cumulative return over various time periods.

**Management Fee (best and final fee proposal)**

Expected ERSRI total cost*	
Effective platform fee	12.5 bps
Effective Operating Expenses	Approx. 6.5 bps
Total Effective Cost*	19 bps
Risk View Total Plan Risk Services \$189,000 (3.15bp)	No Charge

\*\$600m split, 50% systematic trend following strategies, 50% long duration treasuries

**Merits:**

1. BNY Mellon is the current custodian to the ERSRI.
2. The HedgeMark professionals are an experienced, specialized group within the BNY Mellon corporate structure. They project competence.
3. Both Aberdeen and HedgeMark are process driven. The HedgeMark systems are designed with multiple redundancies, seeking to prevent errors.
4. HedgeMark's systems deliver consistent, robust output for Aberdeen to utilize.
5. "Follow the sun" data processing and reconciliation in India provides sun up access to portfolio analytics on a T+1 morning basis.
6. The two firms have the experience of a joint venture implementation with a major pension system's dedicated managed account platform.
7. Experience of the Aberdeen risk team with multiple risk systems provides comfort that they will utilize and interpret risk data correctly. It is anticipated that they will be able to assist the ERSRI in creating valuable metrics for assessing managers in the strategic class.

**Concerns:**

1. Two separate organizations inevitably result in some coordination issues.
2. The Aberdeen / Standard Life merger is a source of uncertainty and distraction for Aberdeen. The merger is not scheduled to close until third quarter 2017.
3. HedgeMark is part of a large, multi-product organization (BNY Mellon) that is not necessarily known for nimbleness.

## Appendix A:

Scope of Services: The RFI includes the following services:

- a) Platform infrastructure – This includes people and systems capable of gathering position and trade data daily on day “T” (the day of the transaction) from managers, brokers, and administrators; reconciling trade and position data nightly; running position data through their risk systems to measure risk taking, monitor risk taking against the manager’s investment management agreement (IMA), flag violations if applicable, and report risk positions to the client prior to market open on “T+1” (next trading day); and calculating and adjusting allocations between managers in order to keep allocations within policy limits.
  
- b) Platform implementation services – These include intra-class rebalancing, cash collateral management and transfer, investment manager operational due diligence, strategy guideline monitoring, risk measurement, risk monitoring, and risk and performance reporting services.

A managed account platform infrastructure provider and platform implementation services manager may be combined in one entity or divided between two entities; however, the contracting entity must agree to act in a fiduciary capacity to the ERSRI.

## Appendix B:

### **MINIMUM QUALIFICATIONS – Platform Services Providers**

#### 1) Required Minimum Qualifications (RMQs)

The Proposer must meet all of the following RMQs, otherwise its proposal will be rejected. For each RMQ, the Proposer must initial alongside each RMQ, indicating that the Proposer has met the RMQ as of December 1, 2016. Any known deviations from the RMQs below must be disclosed in detail on this form. If two entities are bidding jointly (one as platform infrastructure provider and one as platform manager), each must complete and submit this section in their joint proposal.

- Proposer(s) will complete the RFI questionnaire in its entirety.
- Proposing firm(s) must have been in existence for at least five (5) full years.
- Proposing firm(s) managed account assets under management must exceed \$1 billion.
- Platform implementation manager will act a fiduciary to ERSRI.
- Proposing firm(s) must not have been censured by the SEC, CFTC, or subject to regulatory action within the last three (3) years.
- The Proposing firm(s) must be directly responsible for all the services provided, and all personnel responsible for the platform must be employees of the firm(s).
- The Proposing firm(s) must have at least ten professionals dedicated full time to the services provided.
- Proposing firm(s) must have at least 20 professional employees.
- Platform manager must currently manage/oversee and rebalance liquid alternative strategies.
- Platform manager must be registered with the Securities and Exchange Commission (SEC) or foreign equivalent, a Bank, or a licensed Insurance Company Affiliate.
- Platform manager must have at least one public pension plan client.

*Disclosures: This document is provided for informational purposes only. It does not constitute an offer of securities of any of the issuers that may be described herein. Information contained herein may have been provided by third parties, including investment firms providing information on returns and assets under management, and may not have been independently verified. The past performance information contained in this report is not necessarily indicative of future results and there is no assurance that the investment in question will achieve comparable results or that the Firm will be able to implement its investment strategy or achieve its investment objectives. The actual realized value of currently unrealized investments (if any) will depend on a variety of factors, including future operating results, the value of the assets and market conditions at the time of disposition, any related transaction costs and the timing and manner of sale, all of which may differ from the assumptions and circumstances on which any current unrealized valuations are based.*

*Neither PCA nor PCA's officers, employees or agents, make any representation or warranty, express or implied, in relation to the accuracy or completeness of the information contained in this document or any oral information provided in connection herewith, or any data subsequently generated herefrom, and accept no responsibility, obligation or liability (whether direct or indirect, in contract, tort or otherwise) in relation to any of such information. PCA and PCA's officers, employees and agents expressly disclaim any and all liability that may be based on this document and any errors therein or omissions therefrom. Neither PCA nor any of PCA's officers, employees or agents, make any representation of warranty, express or implied, that any transaction has been or may be effected on the terms or in the manner stated in this document, or as to the achievement or reasonableness of future projections, management targets, estimates, prospects or returns, if any. Any views or terms contained herein are preliminary only, and are based on financial, economic, market and other conditions prevailing as of the date of this document and are therefore subject to change.*

*The information contained in this report may include forward-looking statements. Forward-looking statements include a number of risks, uncertainties and other factors beyond the control of the Firm, which may result in material differences in actual results, performance or other expectations. The opinions, estimates and analyses reflect PCA's current judgment, which may change in the future.*

*Any tables, graphs or charts relating to past performance included in this report are intended only to illustrate investment performance for the historical periods shown. Such tables, graphs and charts are not intended to predict future performance and should not be used as the basis for an investment decision.*

*All trademarks or product names mentioned herein are the property of their respective owners. Indices are unmanaged and one cannot invest directly in an index. The index data provided is on an "as is" basis. In no event shall the index providers or its affiliates have any liability of any kind in connection with the index data or the portfolio described herein. Copying or redistributing the index data is strictly prohibited.*

*The Russell indices are either registered trademarks or tradenames of Frank Russell Company in the U.S. and/or other countries.*

*The MSCI indices are trademarks and service marks of MSCI or its subsidiaries.*

*Standard and Poor's (S&P) is a division of The McGraw-Hill Companies, Inc. S&P indices, including the S&P 500, are a registered trademark of The McGraw-Hill Companies, Inc.*

*CBOE, not S&P, calculates and disseminates the BXM Index. The CBOE has a business relationship with Standard & Poor's on the BXM. CBOE and Chicago Board Options Exchange are registered trademarks of the CBOE, and SPX, and CBOE S&P 500 BuyWrite Index BXM are servicemarks of the CBOE. The methodology of the CBOE S&P 500 BuyWrite Index is owned by CBOE and may be covered by one or more patents or pending patent applications.*

*The Barclays Capital indices (formerly known as the Lehman indices) are trademarks of Barclays Capital, Inc.*

*The Citigroup indices are trademarks of Citicorp or its affiliates.*

*The Merrill Lynch indices are trademarks of Merrill Lynch & Co. or its affiliates.*

*FTSE is a trademark of the London Stock Exchange Group companies and is used by FTSE under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. No further distribution of FTSE data is permitted with FTSE's express written consent.*

*While PCA has reviewed the terms of the Fund referred to in this document and other accompanying financial information on predecessor partnerships, this document does not constitute a formal legal review of the partnership terms and other legal documents pertaining to the Fund. PCA recommends that its clients retain separate legal and tax counsel to review the legal and tax aspects and risks of investing in the Fund. Information presented in this report was gathered from documents provided by third party sources, including but not limited to, the private placement memorandum and related updates, due diligence responses, marketing presentations, limited partnership agreement and other supplemental materials. Analysis of information was performed by PCA.*

*An investment in the Fund is speculative and involves a degree of risk and no assurance can be provided that the investment objectives of the Fund will be achieved. Investment in the Fund is suitable only for sophisticated investors who are in a position to tolerate such risk and satisfy themselves that such investment is appropriate for them. The Fund may lack diversification, thereby increasing the risk of loss, and the Fund's performance may be volatile. As a result, an investor could lose all or a substantial amount of its investment. The Fund's governing documents will contain descriptions of certain of the risks associated with an investment in the Fund. In addition, the Fund's fees and expenses may offset its profits. It is unlikely that there will be a secondary market for the shares. There are restrictions on redeeming and transferring shares of the Fund. In making an investment decision, you must rely on your own examination of the Fund and the terms of the offering.*