ND STATE INVESTMENT BOARD MEETING

Friday, March 28, 2014, 8:30 a.m.
Peace Garden Room, State Capitol
600 E Blvd, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

II. ACCEPTANCE OF MINUTES (February 28, 2014)

III. INVESTMENTS

A. Asset and Performance Review - Mr. Hunter (enclosed) (45 min)

B. Service Review - Mr. Hunter (15 min)

C. Watch List Recommendations - Mr. Hunter (enclosed) (30 min) **(Board Approval)**

D. Custody Review Recommendation - Mr. Hunter (enclosed) (30 min) **(Board Approval)**

IV. GOVERNANCE

A. Administration
1. Staff Update - Mr. Hunter (enclosed) (5 min)
2. Audit Committee Update - Mr. Gessner (enclosed) (5 min)

B. Board Education
1. Litigation Monitoring - Ms. Murtha (enclosed) (15 min)
2. Callan College - Mr. Hunter (enclosed) (5 min)

V. OTHER

Next Meetings:
SIB meeting - April 25, 2014, 8:30 a.m. - State Capitol, Peace Garden Room
SIB Audit Committee meeting - May 23, 2014, 1:00 pm - State Capitol, Peace Garden Room

VI. ADJOURNMENT

NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
FEBRUARY 28, 2014, BOARD MEETING

BOARD MEMBERS PRESENT:	Drew Wrigley, Lt. Governor, Chair Mike Sandal, Vice Chair Clarence Corneil, TFFR (Parliamentarian, telecon) Lance Gaebe, Land Commissioner Mike Gessner, TFFR Board Adam Hamm, Insurance Commissioner Rob Lech, TFFR Board Howard Sage, PERS Board Kelly Schmidt, State Treasurer Cindy Ternes, Workforce Safety & Insurance designee Kim Wassim, PERS Board
STAFF PRESENT:	Connie Flanagan, Fiscal & Investment Op Mgr Bonnie Heit, Assistant to the SIB David Hunter, ED/CIO Fay Kopp, Deputy ED/CRO Cody Schmidt, Compliance Officer Darren Schulz, Deputy CIO Susan Walcker, Investment Accountant
OTHERS PRESENT:	Jeff Engleson, Deputy Land Commissioner Levi Erdmann, former SIB & PERS trustee Paul Erlendson, Callan Associates Jan Murtha, Attorney General's Office Bryan Reinhardt, PERS

CALL TO ORDER:

Lt. Governor Wrigley called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, February 28, 2014, at the State Capitol, Peace Garden Room, 600 E Boulevard, Bismarck, ND.

A quorum was present for the purpose of conducting business.

AGENDA:

IT WAS MOVED BY COMMISSIONER GAEBE AND SECONDED BY MR. LECH AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE FEBRUARY 28, 2014, MEETING.

AYES: MS. TERNES, MR. CORNEIL, COMMISSIONER HAMM, TREASURER SCHMIDT, COMMISSIONER GAEBE, MS. WASSIM, MR. LECH, MR. SANDAL, MR. SAGE, MR. GESSNER, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

MINUTES:

The minutes were considered from the January 24, 2014, meeting.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY COMMISSIONER HAMM AND CARRIED ON A VOICE VOTE TO ACCEPT THE JANUARY 24, 2014, MINUTES AS WRITTEN.

AYES: COMMISSIONER HAMM, MS. TERNES, MR. CORNEIL, MR. SANDAL, TREASURER SCHMIDT, MR. GESSNER, MR. SAGE, COMMISSIONER GAEBE, MR. LECH, MS. WASSIM, AND LT. GOVERNOR WRIGLEY

NAYS: NONE
MOTION CARRIED

INVESTMENTS:

Callan – Mr. Erlendson provided commentary on the status of the markets and performance of the Pension and Insurance Trusts for the quarter ending December 31, 2013.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. SAGE AND CARRIED ON A VOICE VOTE TO ACCEPT THE REPORTS GIVEN BY CALLAN.

AYES: MR. LECH, TREASURER SCHMIDT, MR. CORNEIL, COMMISSIONER GAEBE, MS. WASSIM, MR. SANDAL, COMMISSIONER HAMM, MR. GESSNER, MR. SAGE, MS. TERNES, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

The SIB recessed at 10:00 a.m. and reconvened at 10:15 a.m.

Peer Performance – Mr. Hunter stated for the 1 and 3 year periods ended December 31, 2013, the Pension Funds generated gross returns of 17.1% and 9.9% respectively which rank in the 2nd quartile of Callan's public fund sponsor database. For the 5 years ending December 31, 2013, the Funds generated a 11.7% return which ranked in the 3rd quartile.

The Insurance Funds generated gross returns of 5.2% and 8.1% for the 1 and 5 year periods ended December 31, 2013, respectively. These returns were approximately 2% higher than the policy benchmark and benefitted from strong manager selection.

Fee & Custody Review – Mr. Hunter informed the SIB staff would like to conduct an in-depth custodial review of The Northern Trust to confirm service standards and fee levels in conjunction with an outside consultant. Mr. Hunter requested authorization to move forth on the review.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. SANDAL AND CARRIED ON A VOICE VOTE TO ACCEPT STAFF RECOMMENDATION TO CONDUCT A CUSTODIAL REVIEW OF THE NORTHERN TRUST.

AYES: COMMISSIONER HAMM, MS. TERNES, COMMISSIONER GAEBE, MR. GESSNER, MR. SAGE, MS. WASSIM, MR. SANDAL, MR. LECH, MR. CORNEIL, TREASURER SCHMIDT, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

Mr. Hunter also reviewed fee activity. Staff's restructuring of the Pension Global Equity mandate in December 2013 will generate cost savings. Staff has also been conducting relationship reviews to confirm the reasonableness of investment management fees and pursuing fee reductions wherever possible which has generated positive results thus far with a number of managers.

A targeted fee study will also be completed. Staff will be looking at independent third parties to complete the study and will bring back a recommendation to the SIB.

Risk Review & Attribution Analysis – Mr. Schulz reviewed the Pension Trust's risk as measured by standard deviation. During the last 5 years, the Pension Trust's risk has declined by 67% from 11.8% to 3.9%. As a result, the Pension Trust peer risk rating improved to the lowest, 10% or 93rd percentile, in the last year. A low volatility environment for equities contributed to the reduction as well as the restructuring of the fixed income portfolio. Staff will continue to monitor the risk/return profiles of the investment portfolios.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. WASSIM AND CARRIED ON A VOICE VOTE TO ACCEPT THE PERFORMANCE, FEE, AND SERVICE REVIEW REPORTS.

AYES: MR. GESSNER, COMMISSIONER GAEBE, MR. SAGE, TREASURER SCHMIDT, MR. LECH, COMMISSIONER HAMM, MR. CORNEIL, MS. WASSIM, MR. SANDAL, MS. TERNES, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

Watch List – Along with Callan's recommendations, staff also concurs to place PIMCO and Western Asset Management (WAMCO) on the Watch List due to recent management changes and securities litigation, respectively. Staff will be conducting on-site due diligence meetings with the firms and will provide updates to the SIB.

IT WAS MOVED BY MS. TERNES AND SECONDED BY COMMISSIONER GAEBE AND CARRIED BY A VOICE VOTE TO ACCEPT STAFF RECOMMENDATION AND PLACE PIMCO AND WAMCO ON THE WATCH LIST.

AYES: MR. CORNEIL, MR. GESSNER, MR. SANDAL, MR. SAGE, MS. WASSIM, MS. TERNES, COMMISSIONER HAMM, COMMISSIONER GAEBE, MR. LECH, TREASURER SCHMIDT, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

Emerging Market Equity – Mr. Hunter stated as part of the restructuring of the global public equity portfolio within the Pension Trust staff is currently working with Callan to conduct an emerging market equity search. Staff will be making a recommendation to the SIB at a future meeting.

GOVERNANCE:

Technical Legislation Recommendation – Ms. Flanagan reviewed a bill draft to update sections 21-10-02 and 21-10-06 of the NDCC.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. TERNES AND CARRIED ON A VOICE VOTE TO ACCEPT STAFF'S DRAFT OF LEGISLATION TO AMEND AND REENACT SECTIONS 21-10-02 AND 21-10-06 OF THE NDCC RELATING TO MODIFICATIONS TO INVESTMENT POLICIES FOR AND FUNDS UNDER MANAGEMENT OF THE SIB.

AYES: COMMISSIONER GAEBE, TREASURER SCHMIDT, MR. SANDAL, COMMISSIONER HAMM, MR. CORNEIL, MS. TERNES, MR. GESSNER, MS. WASSIM, MR. LECH, MR. SAGE, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

Public Employees Retirement System (PERS) & Legislative Audit & Fiscal Review Committee(LAFRC) – Mr. Hunter and Mr. Schulz met with the PERS Investment Subcommittee to clarify asset class definitions which will be shared with the SIB once completed.

Mr. Hunter stated at the last LAFRC on January 21, 2014, staff fielded questions from the LAFRC regarding the Teachers' Fund for Retirement (TFFR) funded ratio trends. Ms. Kopp has been working with TFFR's actuary, Segal, to address the LAFRC questions.

Staffing Update – Mr. Hunter provided an update on office staff. Staff has been addressing the following vacancies; Audit Supervisor, Information Technology Coordinator, and Investment Analyst.

Mountain States Investor Agenda – Mr. Hunter stated he and Mr. Schulz will be attending the Mountain States Institutional Investor Forum in Denver, CO on March 6, 2014. Mr. Hunter reviewed the agenda and also stated Mr. Erlendson will also be participating as a panelist.

Legal Update – Ms. Murtha reviewed the Halliburton appeal with the SIB. North Dakota recently joined other states in filing an amicus brief in the Halliburton appeal which is currently pending in The U.S. Supreme Court. The Supreme Court accepted the Halliburton case which has the potential to change securities litigation. The Supreme Court will review a precedent that has served as the foundation for shareholder suits for the past 25 years. The Halliburton appeal is requesting The Supreme Court overturn a 1988 ruling that permitted class-action lawsuits based on investors' belief in market prices that were skewed by misrepresentations or omissions. Ms. Murtha will keep the SIB briefed on the status of the Halliburton appeal.

Litigation Monitoring – Mr. Hunter stated staff will work with Ms. Murtha to draft a securities litigation policy for the SIB's consideration. The Northern Trust currently oversees all domestic class actions for the SIB with limited monitoring of foreign actions. Staff will also work with Ms. Murtha to identify a firm(s) to bring before the SIB to present an educational segment on securities litigation monitoring.

Meeting Dates 2014-15 – Staff reviewed a draft of regularly scheduled meetings of the SIB for the 2014-15 fiscal year and recommended nine meetings be scheduled per year instead of 11 which is what has normally been scheduled.

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. SAGE AND CARRIED ON A ROLL CALL VOTE TO SCHEDULE 11 SIB MEETINGS FOR THE 2014-15 FISCAL YEAR.

AYES: MR. GESSNER, COMMISSIONER GAEBE, MR. SAGE, MS. TERNES, TREASURER SCHMIDT, MR. LECH, COMMISSIONER HAMM, MS. WASSIM, MR. SANDAL, AND LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED
ABSENT: MR. CORNEIL

OTHER:

The next SIB meeting is scheduled for March 28, 2014, at 8:30 am at the Peace Garden Room, State Capitol, Bismarck, ND.

The next SIB Audit Committee meeting is scheduled for February 28, 2014, at 1:00 pm at the Peace Garden Room, State Capitol, Bismarck, ND.

ADJOURNMENT:

With no further business to come before the SIB, Lt. Governor Wrigley adjourned the meeting at 11:45 a.m.

Lt. Governor Wrigley, Chair
State Investment Board

Bonnie Heit
Assistant to the Board

Agenda Item III. **A.**

State Investment Board

Asset and Performance Review

March 28, 2014

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Executive Summary

- **Assets Under Management ("AUM")** – AUM grew by $1.1 billion (or 15%) during the last six months of 2013 and approximated $8.5 billion at year-end. Net investment income was responsible for gains of nearly 10% ($400 million) for the Pension Trust and 3.5% ($115 million) for the Insurance Trust, while Legacy assets increased by over 47% ($565 million).

- **Client Level Reporting** – RIO staff is working with Callan to develop enhanced performance reporting for SIB's five largest clients. These enhancements will be implemented over the next 90 days. In the interim, we are providing expanded attribution reporting for the Pension and Insurance Trusts over the last 1- and 3- and 5-year periods.

- **Watch List** – Staff **recommends** that Loomis, PIMCO & WAMCO be retained on the Watch List. Staff further **recommends** the SIB approve a manager search for the WAMCO MBS strategy ($115 million pension) as the recent SEC and Department of Labor "Regulatory Settlement" involved ABS/MBS products and has coincided with significant management turnover. Specifically, the Head of Agency MBS, Head of Structured Products and Co-Head of Structured Products have resigned or retired since 2012.

- **Emerging Market Equity Update** – The Staff is working with Callan to conduct an Emerging Market Equity Search over the next several months.

- **Custody Review** – The RIO Staff **recommends** that Callan is engaged to perform a review of Northern Trust's custody services to confirm performance standards and fee levels including a proposal to adopt a conservative securities lending program.

State Investment Board - Assets Under Management

Fund Name	Market Values as of 12/31/13 [1]	Market Values as of 6/30/13 [2]
Pension Trust Fund		
Public Employees Retirement System (PERS)	2,204,819,633	2,000,899,336
Teachers' Fund for Retirement (TFFR)	1,970,377,031	1,810,735,455
Job Service of North Dakota Pension	95,276,201	90,442,764
City of Bismarck Employees Pension	74,832,971	68,822,847
City of Grand Forks Employees Pension	53,459,799	50,148,061
City of Bismarck Police Pension	32,887,889	30,072,819
Grand Forks Park District	5,653,023	5,109,311
City of Fargo Employees Pension	4,742,525	34,133,671
Subtotal Pension Trust Fund	4,442,049,072	4,090,364,264
Insurance Trust Fund		
Legacy Fund	1,695,950,111	1,194,779,193
Workforce Safety & Insurance (WSI)	1,627,545,930	1,557,719,286
Budget Stabilization Fund	588,744,084	401,353,181
PERS Group Insurance Account	39,626,348	42,792,878
City of Fargo FargoDome Permanent Fund	38,668,924	36,411,591
State Fire and Tornado Fund	28,625,262	26,633,417
Petroleum Tank Release Compensation Fund	6,899,622	6,839,483
State Risk Management Fund	6,593,046	6,187,298
State Risk Management Workers Comp Fund	5,654,121	5,247,448
State Bonding Fund	3,171,622	3,141,218
ND Association of Counties (NDACo) Fund	2,894,408	2,717,444
Insurance Regulatory Trust Fund	1,107,837	1,043,647
Bismarck Deferred Sick Leave Account	807,624	1,016,834
Cultural Endowment Fund	359,577	323,914
Subtotal Insurance Trust Fund	4,046,648,516	3,286,206,832
PERS Retiree Insurance Credit Fund	83,492,581	73,677,263
Total Assets Under SIB Management	8,572,190,169	7,450,248,360

[1] *12/31/13 market values are unaudited and subject to change.*

[2] *6/30/13 market values as stated in the Comprehensive Annual Financial Report.*

- **Client Assets Under Management grew by $1.1 billion (or 15%) during the last half of 2013 and exceeded $8.5 billion at year-end.**
- **Net investment income was responsible for gains of nearly 10% ($400 million) for the Pension Trust and 3.5% ($115 million) for the Insurance Trust.**
- **Legacy assets increased by over 47% ($565 million) primarily due to tax collections.**
- **As of February 28, 2014, the market value of SIB client assets approached $8.7 billion.**

Estimated Fiscal YTD Returns to March 26, 2014

Estimated YTD Through 3/26/2014
(Actual returns are net of fees; estimates are gross indices)

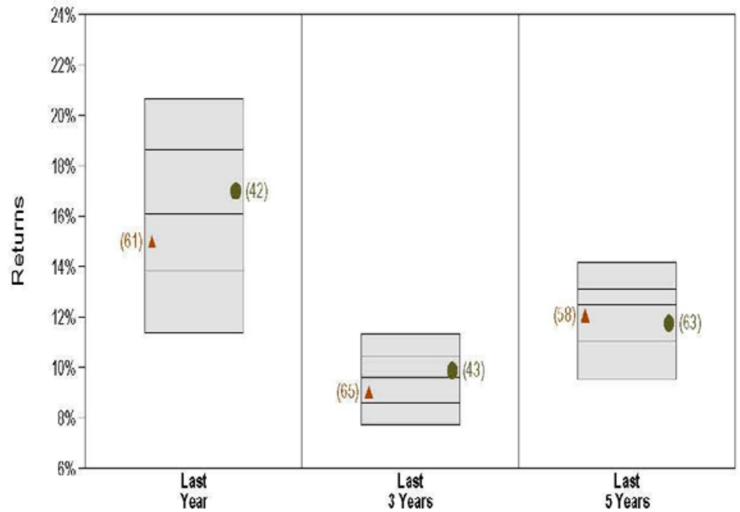
Key Point: Estimated FYTD Returns > Policy Benchmark

		TFFR	PERS	WSI	Legacy	Budget Stabilization	Pension Trust	Insurance Trust
Market Value	**31-Jan**	**1,934,680,548**	**2,169,024,933**	**1,620,863,760**	**1,759,467,974**	**588,278,222**	**4,366,849,486**	**3,990,774,650**
Total Fund Actual through	31-Jan	**8.71%**	**8.57%**	**6.00%**	**2.54%**	**1.11%**	**8.54%**	**3.88%**
Total Fund Policy through	31-Jan	8.30%	8.21%	5.08%	1.83%	0.41%	8.49%	3.12%
	28-Feb							
MSCI World	5.01%	16.0%	16.0%	0.0%	0.0%	0.0%	16.0%	0.0%
Russell 1000	4.75%	16.6%	16.6%	9.8%	9.8%	0.0%	16.5%	8.7%
Russell 2000	4.71%	4.8%	4.8%	3.3%	3.6%	0.0%	4.9%	3.1%
EAFE	5.56%	11.8%	11.1%	7.0%	9.6%	0.0%	11.1%	7.3%
Emerging Mkts	3.31%	2.8%	3.5%	0.0%	0.0%	0.0%	3.1%	0.0%
BC Agg	0.53%	12.0%	12.0%	51.0%	24.9%	0.0%	13.1%	32.9%
BC High Yield	2.02%	5.0%	5.0%	0.0%	0.0%	0.0%	5.1%	0.0%
BC Global Agg ex US	0.43%	5.0%	5.0%	0.0%	0.0%	0.0%	5.0%	0.0%
Real Estate	0.84%	20.0%	20.0%	6.0%	3.5%	0.0%	19.4%	4.0%
Private Equity	0.00%	5.0%	5.0%	0.0%	0.0%	0.0%	4.9%	0.0%
TIPS	1.65%	0.0%	0.0%	22.0%	0.0%	0.0%	0.0%	9.0%
ML 1-3Y Treasury	0.09%	0.0%	0.0%	0.0%	48.6%	100.0%	0.0%	33.0%
T-Bill	0.00%	1.0%	1.0%	1.0%	0.0%	0.0%	1.0%	2.0%
Est. MTD through	**2/28/2014**	**2.92%**	**2.90%**	**1.69%**	**1.37%**	**0.09%**	**2.89%**	**1.35%**
	26-Mar							
MSCI World	-1.07%	16.0%	16.0%	0.0%	0.0%	0.0%	16.0%	0.0%
Russell 1000	-0.55%	16.6%	16.6%	9.8%	9.8%	0.0%	16.5%	8.7%
Russell 2000	-2.22%	4.8%	4.8%	3.3%	3.6%	0.0%	4.9%	3.1%
EAFE	-1.93%	11.8%	11.1%	7.0%	9.6%	0.0%	11.1%	7.3%
Emerging Mkts	0.33%	2.8%	3.5%	0.0%	0.0%	0.0%	3.1%	0.0%
BC Agg	-0.11%	12.0%	12.0%	51.0%	24.9%	0.0%	13.1%	32.9%
BC High Yield	0.11%	5.0%	5.0%	0.0%	0.0%	0.0%	5.1%	0.0%
BC Global Agg ex US	0.01%	5.0%	5.0%	0.0%	0.0%	0.0%	5.0%	0.0%
Real Estate	0.72%	20.0%	20.0%	6.0%	3.5%	0.0%	19.4%	4.0%
Private Equity	0.00%	5.0%	5.0%	0.0%	0.0%	0.0%	4.9%	0.0%
TIPS	-0.30%	0.0%	0.0%	22.0%	0.0%	0.0%	0.0%	9.0%
ML 1-3Y Treasury	-0.13%	0.0%	0.0%	0.0%	48.6%	100.0%	0.0%	33.0%
T-Bill	0.01%	1.0%	1.0%	1.0%	0.0%	0.0%	1.0%	2.0%
Est. MTD through	**3/26/2014**	**-0.45%**	**-0.43%**	**-0.34%**	**-0.38%**	**-0.13%**	**-0.44%**	**-0.33%**
Estimated FYTD Return	**3/26/2014**	**11.38%**	**11.24%**	**7.42%**	**3.55%**	**1.07%**	**11.19%**	**4.93%**
Estimated FYTD Policy	3/26/2014	10.96%	10.87%	6.49%	2.83%	0.37%	11.13%	4.16%
Comparison to 8% return assumption pro-rated FYTD		***5.84%***	***5.84%***				***5.84%***	

Peer Performance - Pension Trust Total Fund Ranking

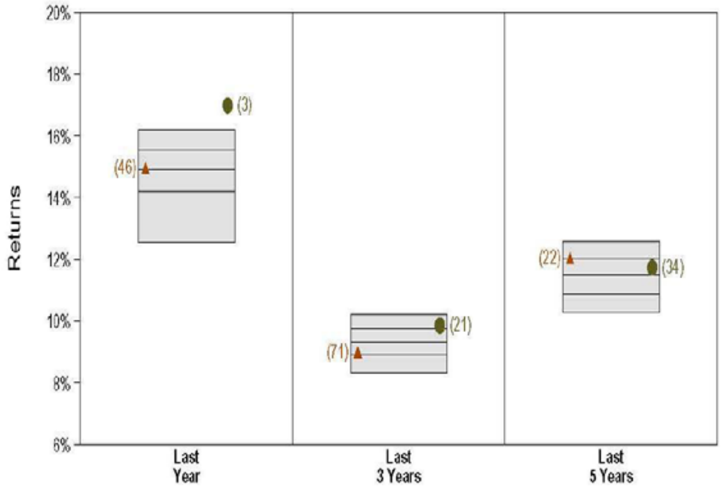
The two charts show the ranking of the Total Fund's performance relative to that of the Public Fund Sponsor Database for periods ended December 31, 2013. The left chart is a standard unadjusted ranking. In the right chart each fund in the database is adjusted to have the same historical asset allocations that of the Total Fund.

Public Fund Sponsor Database



	Last Year	Last 3 Years	Last 5 Years
10th Percentile	20.61	11.29	14.12
25th Percentile	18.62	10.44	13.11
Median	16.06	9.58	12.45
75th Percentile	13.80	8.57	11.04
90th Percentile	11.32	7.71	9.51
Total Fund ●	16.98	9.85	11.73
Policy Target ▲	14.96	8.98	12.04

Asset Allocation Adjusted Ranking



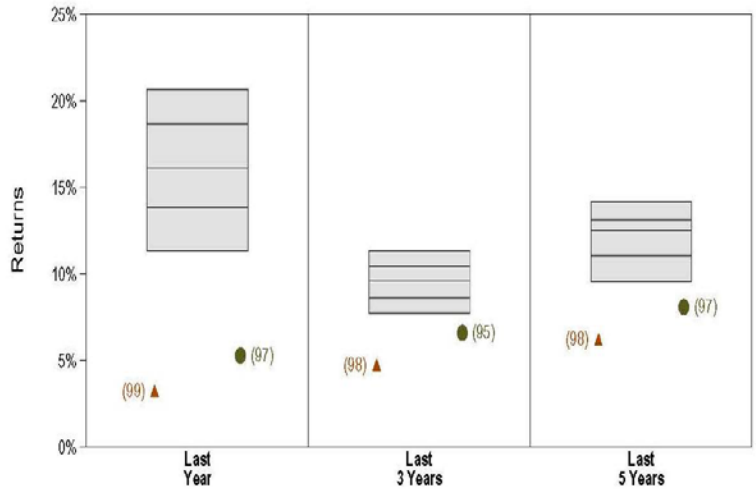
	Last Year	Last 3 Years	Last 5 Years
10th Percentile	16.18	10.20	12.57
25th Percentile	15.54	9.75	12.01
Median	14.92	9.31	11.49
75th Percentile	14.21	8.91	10.86
90th Percentile	12.55	8.31	10.27
Total Fund ●	16.98	9.85	11.73
Policy Target ▲	14.96	8.98	12.04

* Current Quarter Target = 16.4% Russell 1000 Index, 16.0% MSCI World Index, 13.1% Barclays Aggregate Index, 11.1% MSCI EAFE Index, 9.7% NCREIF Total Index, 5.0% Barclays HY Corp 2% Issue, 5.0% Barclays Global Agg ex US, 4.9% CPI-W, 4.9% Russell 2000 Index, 4.9% NDSIB PEN - Private Equity, 4.9% NCREIF Timberland Index, 3.1% Emerging Mkts - Net and 1.0% 3-month Treasury Bill.

Peer Performance - Insurance Trust Total Fund Ranking

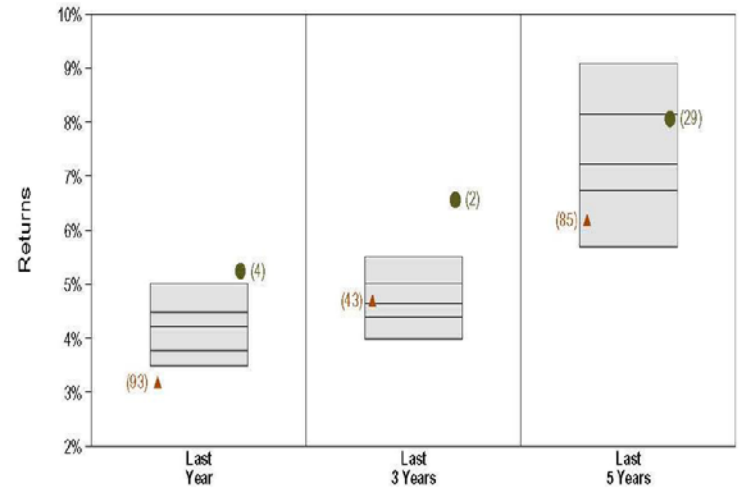
The two charts show the ranking of the Total Fund's performance relative to that of the Public Fund Sponsor Database for periods ended December 31, 2013. The left chart is a standard unadjusted ranking. The right chart each fund in the database is adjusted to have the same historical asset allocation as that of the Total Fund.

Public Fund Sponsor Database



	Last Year	Last 3 Years	Last 5 Years
10th Percentile	20.61	11.29	14.12
25th Percentile	18.62	10.44	13.11
Median	16.06	9.58	12.45
75th Percentile	13.80	8.57	11.04
90th Percentile	11.32	7.71	9.51
Total Fund ●	5.24	6.56	8.06
Policy Target ▲	3.18	4.69	6.18

Asset Allocation Adjusted Ranking



	Last Year	Last 3 Years	Last 5 Years
10th Percentile	5.01	5.52	9.08
25th Percentile	4.48	5.01	8.15
Median	4.22	4.64	7.21
75th Percentile	3.78	4.38	6.75
90th Percentile	3.48	3.97	5.69
Total Fund ●	5.24	6.56	8.06
Policy Target ▲	3.18	4.69	6.18

* Current Quarter Target = 38.8% Barclays Gov 1-3 Yr, 30.5% Barclays Aggregate Index, 9.2% Barclays Glbl Inftn-Lnked, 7.4% Russell 1000 Index, 6.1% MSCI EAFE Index, 2.7% 3-month Treasury Bill, 2.7% NCREIF Total Index and 2.6% Russell 2000 Index.

Pension Trust – Calendar Year 2013
Contribution to Relative Return

	1 Year	3 Year	5 Year
Total Fund Excess Return	**2.02%**	**0.87%**	**-0.31%**
Asset Allocation	**0.28%**	**-0.01%**	**-0.70%**
Manager Selection	**1.73%**	**0.88%**	**0.39%**
Global Equity	0.45%	0.00%	0.06%
Domestic Equity	0.54%	0.11%	0.13%
International Equity	0.37%	0.25%	0.48%
Private Equity	0.00%	0.00%	0.00%
Domestic Fixed Income	0.27%	0.23%	-0.09%
International Fixed Income	-0.03%	0.11%	0.27%
Real Estate	0.34%	0.25%	-0.38%
Timber	-0.44%	-0.21%	-0.20%
Infrastructure	0.23%	0.13%	0.12%
Cash Equivalents	0.00%	0.00%	0.00%

Manager Selection within Global, Large Cap Domestic and Developed International Equities accounted for 60% of positive relative performance followed by Real Estate at 17%.

Insurance Trust – Calendar Year 2013 Contribution to Relative Return

	1 Year	3 Year	5 Year
Total Fund Excess Return	**2.07%**	**1.87%**	**1.88%**
Asset Allocation	**0.14%**	**0.06%**	**-0.12%**
Manager Selection	**1.93%**	**1.81%**	**2.00%**
Large Cap Domestic Equity	0.19%	0.04%	-0.16%
Small Cap Domestic Equity	0.05%	0.04%	0.09%
International Equity	0.11%	0.06%	0.14%
Fixed Income	0.64%	1.09%	2.12%
Inflation Protected Assets	0.39%	-0.08%	-0.23%
Real Estate	0.25%	0.41%	-0.37%
Short Term Fixed Income	0.29%	0.26%	0.41%
Cash Equivalents	0.00%	0.00%	0.01%

Manager Selection was positive across all asset classes within the Insurance Trust. Fixed income contributed 31% of positive relative performance followed by Inflation Protected Assets at 19%, within which Infrastructure was a key driver.

Relationship Reviews, Fee Savings & Upcoming Projects

- **Relationship Reviews** - Since December, RIO has met with managers responsible for investing **$6 billion in SIB client assets** including JPMorgan ($1.2 billion), Babson ($800 million), Western ($780 million), LA Capital ($670 million), LSV ($650 million), Northern Trust ($580 million), PIMCO ($410 million), Cap Guardian ($250 million), TIR ($250 million), Loomis Sayles ($200 million), Callan ($145 million), and UBS ($100 million).
- **Fee Savings** - During the last four months, RIO has identified over **$2.2 million** in annual cost savings including a recent **$280,000/year** fee reduction in custody services. This estimate excludes the potential impact of a securities lending program which could generate **$900,000/year** of incremental income.
- **Fiscal Year End Estimates** - Based on forecasted asset levels, projected performance fees and targeted fee reductions, RIO staff expects investment fees to decline to **55 bps** in fiscal 2014.
- **Private Equity Preview** - During the next several months, RIO intends to conduct a review of our Private Equity, Infrastructure and Timber strategies. These reviews should serve to confirm our investment approach to less liquid strategies, rationalize smaller investments with limited upside, while easing administrative reporting demands and potentially identify additional cost savings.
- **Strategy Risk & Return Summary** – RIO staff will preview a three page management report used to highlight underperforming strategies and prioritize relationship reviews.

Investment Manager Assets Under Management ("AUM") and Fees - Relationship Reviews Prioritized by AUM and Annual Fees Paid in Fiscal 2013

Unaudited Data Subject to Change		Avg Market Value	Investment Manager Fees Paid in FY 2013	Investment Manager Fees %		Net Manager Fees
1	J.P. MORGAN	$1,015,200,890	$5,811,082	0.57%		0.57%
2	BABSON	$575,839,079	$758,881	0.13%		0.13%
3	LA CAPITAL	$515,772,684	$1,086,380	0.21%		0.21%
4	WESTERN	$502,277,941	$894,348	0.18%		0.18%
5	CLIFTON	$490,225,426	$863,595	0.18%	*	0.04%
6	LSV	$487,792,473	$2,481,730	0.51%	*	0.30%
7	PIMCO	$400,802,720	$13,177,910	3.29%	*	0.64%
8	WELLS	$280,345,750	$613,148	0.22%		0.22%
9	TIR	$260,597,741	$1,279,439	0.49%		0.49%
10	INVESCO	$245,216,424	$2,229,471	0.91%	*	0.62%
11	BANK OF ND	$190,480,934	$80,718	0.04%		0.04%
12	EPOCH	$187,755,328	$1,412,498	0.75%		0.75%
13	LOOMIS SAYLES	$176,536,925	$882,685	0.50%		0.50%
14	UBS	$127,174,470	$577,148	0.45%		0.45%
15	CALLAN	$119,901,922	$834,282	0.70%		0.70%
16	DECLARATION	$114,357,118	$618,842	0.54%		0.54%
17	NORTHERN TRUST NTGI	$109,202,332	$307,640	0.28%	*	0.03%
18	CAPITAL GUARDIAN	$108,447,374	$547,646	0.50%		0.50%
19	BRANDYWINE	$103,743,039	$427,726	0.41%		0.41%
20	DFA	$101,905,746	$687,260	0.67%		0.67%
21	STATE STREET	$89,660,762	$251,892	0.28%		0.28%
22	PRUDENTIAL	$69,466,857	$204,186	0.29%		0.29%
23	WELLINGTON	$65,752,285	$561,118	0.85%		0.85%
24	SEI	$58,844,793	$294,454	0.50%		0.50%
25	CALAMOS	$53,732,841	$386,180	0.72%		0.72%
26	ADAMS STREET/BRINSON	$51,767,770	$982,338	1.90%		1.90%
27	NORTHERN TRUST STIF	$41,947,286	$60,935	0.15%		0.15%
28	CREDIT SUISSE	$40,658,091	$665,651	1.64%	*	1.11%
29	CORSAIR	$32,490,963	$736,920	2.27%		2.27%
30	EIG	$32,042,116	$365,606	1.14%		1.14%
31	RESEARCH AFFILIATES	$31,076,018	$138,437	0.45%		0.45%
32	CAPITAL INT'L	$28,714,648	$768,528	2.68%		2.68%
33	MATLIN PATTERSON	$27,338,691	-$427,782	*n.m.*		*n.m.*
34	QUANTUM	$18,902,357	$896,941	4.75%		4.75%
35	PANAGORA	$16,618,079	$116,010	0.70%		0.70%
36	INVEST AMERICA	$15,313,985	$536,928	3.51%		3.51%
37	GOLDMAN SACHS	$14,859,358	$754,745	5.08%	*	2.13%
38	VANGUARD	$10,727,178	$45,054	0.42%		0.42%
39	CORAL PARTNERS	$3,759,373	$129,958	3.46%		3.46%
40	HEARTHSTONE	$1,458	$566	*n.m.*		*n.m.*
	Pension & Insurance Trusts	$6,817,251,224	$43,041,094	0.63%		0.43%
			Annual Fees**	**Gross Fee**		**Net Fee*****

** - Performance Fees were $14 million in aggregate for FY 13.* *n.m. = not meaningful*
*** - Annual Fees excludes $1.6 million in Custodian, Investment Consultant and Service Fees for the Pension and Insurance Trusts.*
**** - Net Investment Management Fees excludes the impact of Performance Fees.*

Note: During the last 1-, 3- and 10-year periods ended 12/31/13, the North Dakota Pension Fund Trust generated investment returns which were in the 2nd Quartile of the Callan Associates Public Fund Sponsor Database.

Pension and Insurance Fee Summary*

*Preliminary and Subject to Change

	Forecast	----------- Fiscal Year Ended -----------		
	Fiscal 2014	6/30/2013	6/30/2012	6/30/2011
Pension Trust	0.69%	0.79%	0.71%	0.81%
Insurance Trust	0.39%	0.40%	0.42%	0.34%
Total	**0.55%**	**0.63%**	**0.61%**	**0.66%**

Agenda Item III. **B.**

State Investment Board

Service Review

March 28, 2014

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Manager Search Process Overview

- The Process:
  - Every search starts from scratch, no “Approved” or “Buy” lists
  - Backed by extensive due diligence and accumulated knowledge of specialist and generalist consultants
  - Disciplined and Consistent
  - Client driven, customized
  - Utilizes peer review—Manager Search Committee to ensure quality control
- The Outcome:
  - The identification of the managers and products that are the best fit for the investment program and the specific mandate.
- Client Cooperation:
  - All parts of this process are transparent and client involvement is encouraged. Any part of this process can be used to supplement a client’s existing search process.

Manager Search Process

- Client and Manager Profiles
- Quantitative Screening
- Qualitative Screening
- Manager Search Committee
- Semi-Finalist Review
- **Finalists**

Dave Hunter, CIO and Darren Schulz, Deputy CIO
North Dakota Retirement & Investment Office

600 Montgomery Street
Suite 800
San Francisco, CA 94111
Callan Conference Room

Thursday, March 20, 2014

8:00 Global Manager Research: Fixed-Income
PIMCO and Western Asset discussion
Steve Center, CFA, VP (via conference call)
Brett Cornwell, CFA, VP

9:00 Trust, Custody and Securities Lending Group
Plan for service and benchmarking project
Mark Kinoshita, VP

10:00 Global Manager Research: Non-US Equity
Status of Emerging Market Equity Search
Andy Iseri, CFA, VP
Ho Hwang, AVP
Lyman Jung, AVP

11:00 Operations and Performance Measurement
Overview of Callan; office tour
Ivan "Butch" Cliff, CFA, EVP, Director of Investment Research & Operations

Noon Lunch w/ Callan Leadership Team
Greg Allen, President and Director of Research
Butch Cliff, CFA, EVP, Director of Investment Research & Operations
Inga Sweet, SVP, Manager of Global Manager Research
Paul Erlendson, SVP, Fund Sponsor Consulting Group

1:15 Depart for airport

MANAGER	% Total MV (12-31-13)	Market Value 12/31/2013	Returns 1 Yr	Returns 3 Yr	Returns 5 Yr	Returns Inception	Standard Deviation (Risk) 1 Yr	Standard Deviation (Risk) 3 Yr	Standard Deviation (Risk) 5 Yr	Standard Deviation (Risk) Inception	Excess Returns [1] 1 Yr	Excess Returns [1] 3 Yr	Excess Returns [1] 5 Yr	Excess Returns [1] Inception	FEES FY13	
ADAMS ST/BRINSON	0.60%	$ 50,811,329													$ 982,338	
PEN Adams St 2003		$ 797,578	19.84	7.98	6.16	6.42	6.30	7.96	11.82	11.04	--	--	--	--		
PEN Adams St 2010 Dir Fd		$ 1,130,451	13.53	10.50	--	4.65	9.37	7.54	--	9.00	--	--	--	--		
PEN Adams St 2010 Non-US Fd		$ 1,659,810	7.71	3.08	--	(11.92)	4.70	9.23	--	23.34	--	--	--	--	$ 203,933	4.1497%
PEN Adams St 2010 US Fd		$ 3,248,826	9.40	10.69	--	11.29	3.76	3.45	--	8.56	--	--	--	--		
PEN Adams St Dir Co-Invest.		$ 16,666,477	16.98	12.47	5.85	2.17	8.19	8.79	15.13	13.46	--	--	--	--	$ 326,898	1.8954%
PEN Adams St 2008 Fd		$ 5,398,819	10.80	7.39	1.52	(2.30)	5.29	7.15	11.61	11.78	--	--	--	--	$ 101,696	2.3456%
PEN Adams St 2010 Non-US Em		$ 472,829	(4.41)	(14.81)	--	(14.81)	1.09	9.26	--	9.26	--	--	--	--		
PEN Adams St BVCF		$ 5,309,330	40.21	44.24	53.40	13.75	19.31	18.54	48.87	33.83	--	--	--	--	$ 205,334	4.7132%
PEN Adams St Non US		$ 555,639	20.18	23.07	13.72	16.03	11.19	16.48	19.16	20.32	--	--	--	--	$ 60,982	0.7276%
PEN Adams St 1999		$ 869,492	13.70	10.07	4.02	4.21	8.83	9.99	13.38	12.93	--	--	--	--	$ 55,787	0.8925%
PEN Adams St 2000		$ 3,007,408	(1.52)	7.39	5.33	4.55	4.31	6.26	10.39	9.95	--	--	--	--		
PEN Adams St 2001		$ 3,044,348	14.05	11.82	7.28	4.86	8.81	6.61	11.09	9.04	--	--	--	--		
PEN Adams St 2002		$ 1,898,781	7.71	12.47	7.78	7.54	6.09	7.02	15.00	14.19	--	--	--	--		
PEN Adams St 1998 Partner		$ 120,110	11.10	2.03	0.98	3.78	9.25	11.36	9.99	16.22	--	--	--	--	$ 27,708	0.4433%
PEN Adams St 2000 Non US		$ 1,064,903	(5.58)	0.33	(0.12)	8.03	4.79	7.51	16.04	14.89	--	--	--	--		
PEN Adams St 2001 Non US		$ 553,673	20.38	4.46	(0.35)	2.68	15.01	14.88	20.74	17.06	--	--	--	--		
PEN Adams St 2002 Non US		$ 1,975,187	2.20	7.33	1.47	12.24	5.97	7.24	18.40	18.34						
PEN Adams St 2004 Non US		$ 1,149,636	6.30	5.36	0.63	6.05	4.78	7.99	15.58	13.86	--	--	--	--		
PEN Adams St 2003 Non US		$ 1,888,032	17.93	12.26	10.35	13.70	11.45	13.45	21.09	19.51	--	--	--	--		
BABSON	9.52%	$ 805,685,372													$ 752,994	
INS Budget Stab.		$ 233,633,209	2.05	--	--	2.58	1.07	--	--	0.78	1.68	--	--	2.09	$ 210,409	0.1420%
INS Legacy		$ 572,052,163	1.32	--	--	2.09	0.58	--	--	0.64	0.94	--	--	1.65	$ 542,585	0.1279%
BRANDYWINE	1.24%	$ 105,136,244													$ 427,726	
PEN Intl Fixed Pool		$ 105,136,244	(3.31)	6.77	11.05	8.32	3.43	4.59	8.41	7.66	(0.71)	4.38	7.14	3.29	$ 427,726	0.4123%
CALLAN	1.70%	$ 144,190,081													$ 834,282	
PEN Small Cap Equity		$ 144,190,081	45.22	17.54	23.77	9.61	7.21	21.51	22.87	23.77	6.40	1.87	3.69	1.62	$ 834,282	0.6958%
CAPITAL GUARDIAN	2.41%	$ 203,896,834													$ 547,646	
PEN Intl Equity		$ 104,833,612	25.58	9.35	12.8	8.9	9	16.79	18.33	18.48	2.80	1.18	0.36	3.02	$ 307,729	0.4838%
INS Intl Equity		$ 99,063,222	23.09	8.79	12.85	6.74	9.59	17.43	18.6	21.29	0.31	0.63	0.41	1.33	$ 239,917	0.5350%
CAPITAL INT'L	0.38%	$ 32,066,217													$ 768,528	
PEN Fund V		$ 19,933,331	(5.31)	6.65	3.63	1.47	14.87	19.00	22.48	20.72	--	--	--	--	$ 249,362	1.0845%
PEN Fund VI		$ 12,132,886	(21.85)	--	--	(19.27)	12.49	--	--	19.24	--	--	--	--	$ 519,166	9.0755%
CLIFTON	4.53%	$ 383,497,978													$ 690,827	
PEN Enhanced S&P		$ 153,616,924	30.96	--	--	15.16	7.94	--	--	16.16	(1.43)	--	--	(0.18)	$ (139,667)	-0.1214%
PEN Enhanced Small Cap		$ 113,466,879	38.61	16.84	--	19.82	8.27	20.36	--	20.31	(0.21)	1.17	--	1.45	$ 665,402	0.5897%
INS Large Cap		$ 61,095,620	31.23	16.43	19.83	19.83	7.70	15.49	18.11	18.11	(1.16)	0.25	1.89	1.89	$ 35,780	0.1041%
INS Small Cap		$ 55,318,555	38.39	16.79	22.73	22.73	8.14	20.41	22.95	22.95	(0.43)	1.12	2.65	2.65	$ 129,312	0.4284%
CORAL PARTNERS	0.03%	$ 2,506,298													$ 129,958	
PEN Fund V			--	--	--	--	--	--	--	--	--	--	--	--	$ -	0%
PEN Momentum		$ 2,506,298	(0.10)	(15.92)	(17.77)	(14.81)	23.57	28.51	28.15	24.41	--	--	--	--	$ 129,958	3.6027%
PEN Supplemental (V)			--	--	--	--	--	--	--	--	--	--	--	--	$ -	0%
CORSAIR	0.42%	$ 35,441,666													$ 736,920	
PEN Fund III		$ 12,336,631	0.61	(1.38)	2.24	(8.81)	9.08	8.66	23.79	38.07	--	--	--	--	$ 200,022	1.6835%
PEN Fund III ND Investors		$ 11,610,720	8.70	4.36	2.18	1.81	11.45	6.67	5.27	4.92	--	--	--	--	$ 100,000	0.9241%
PEN Fund IV		$ 11,494,315	15.41	(1.89)	--	(3.65)	12.72	14.69	--	13.77	--	--	--	--	$ 436,897	4.4635%

Please note all data is preliminary and subject to change

MANAGER	% Total MV (12-31-13)	Market Value 12/31/2013	Returns 1 Yr	Returns 3 Yr	Returns 5 Yr	Returns Inception	Standard Deviation (Risk) 1 Yr	Standard Deviation (Risk) 3 Yr	Standard Deviation (Risk) 5 Yr	Standard Deviation (Risk) Inception	Excess Returns[1] 1 Yr	Excess Returns[1] 3 Yr	Excess Returns[1] 5 Yr	Excess Returns[1] Inception	FEES FY13	
CREDIT SUISSE	0.57%	$ 48,329,577													$ 665,651	
PEN Infastructure		$ 32,219,725	10.36	--	--	13.42	8.62	--	--	12.23	8.91	--	--	11.85	$ 300,000	1.1068%
PEN Infastructure Performance															$ 143,767	0.5304%
INS Infastructure		$ 16,109,852	10.36	--	--	13.42	8.62	--	--	12.23	13.56	--	--	11.17	$ 150,000	1.1068%
INS Infastructure Performance															$ 71,884	0.5304%
DECLARATION	1.43%	$ 120,658,558													$ 618,842	
PEN Total Return		$ 65,482,387	3.18	--	--	6.75	3.23	--	--	3.25	2.91	--	--	6.41	$ 350,673	0.5860%
INS Total Return		$ 27,180,857	--	--	--	(0.02)	--	--	--	0.00	--	--	--	(0.08)		
INS Fixed Pool (Hyperion)		$ 27,995,314	(0.39)	5.39	--	6.32	2.42	3.08	--	2.89	(0.75)	1.90	--	2.66	$ 268,169	0.4919%
DFA	1.60%	$ 135,371,002													$ 687,260	
PEN Intl Equity		$ 75,782,268	33.25	10.81	17.80	4.89	15.30	22.13	26.84	28.43	9.20	3.86	2.06	2.88	$ 380,923	0.6566%
PEN Emerging Markets		$ 33,574,344	(0.74)	(1.14)	20.52	11.36	10.66	20.82	29.51	29.81	1.86	0.92	5.72	3.71	$ 235,763	0.7113%
INS Intl Equity		$ 26,014,390	33.19	10.80	17.79	4.89	15.30	22.13	26.84	28.43	9.14	3.84	2.05	2.87	$ 70,574	0.6566%
EIG	0.28%	$ 23,768,236													$ 365,606	
PEN Private Equity		$ 23,768,236	(4.08)	3.07	8.09	8.83	5.55	6.13	6.6	7.94	--	--	--	--	$ 365,606	1.1410%
EPOCH	3.52%	$ 298,075,759													$ 1,412,498	
PEN Global Equity		$ 298,075,759	33.33	--	--	23.83	4.90	--	--	10.18	6.65	--	--	2.70	$ 1,412,498	0.7523%
GOLDMAN SACHS	0.16%	$ 13,939,572													$ 754,745	
PEN 2006		$ 3,254,184	18.49	5.67	7.64	2.31	7.07	17.06	31	25.91	11.06	(3.62)	(11.32)	(6.69)	$ 79,011	1.7892%
PEN Fund V		$ 10,685,388	13.8	16.81	14.63	10.98	8.26	13.64	13.8	13.37	6.36	7.51	(4.33)	1.04	$ 237,582	2.2749%
PEN Fund V Performance															$ 438,152	4.1955%
INVESCO	3.20%	$ 271,063,623													$ 2,229,471	
PEN Core		$ 150,348,150	16.67	13.18	2.78	7.67	2.83	3.77	11.81	7.96	5.69	1.26	(2.90)	(1.86)	$ 535,996	0.3986%
PEN Fund II		$ 23,596,823	18.76	25.96	(13.88)	(17.21)	14.61	11.15	40.70	37.69	7.79	14.05	(19.57)	(20.77)	$ 220,089	0.5939%
PEN Fund III		$ 23,299,114	19.08	--	--	15.57	13.92	--	--	11.41	8.10	--	--	4.88	$ 211,994	0.8444%
PEN Fund III Performance															$ 711,563	2.8344%
PEN Asia		$ 27,375,071	(3.23)	(2.13)	(29.60)	(29.60)	13.49	10.64	35.59	35.59	(14.21)	(14.04)	(35.28)	(35.28)	$ 425,096	2.4929%
INS Core		$ 46,444,465	16.68	--	--	13.13	2.83	--	--	4.29	5.70	--	--	2.24	$ 124,733	0.3956%
INVEST AMERICA	0.19%	$ 16,278,312													$ 536,928	
PEN Lewis & Clark		$ 6,121,587	17.77	10.58	6.72	2.31	9.99	7.83	11.35	19.48	--	--	--	--	$ 161,928	2.5570%
PEN Lewis & Clark II		$ 10,156,725	(4.18)	(5.04)	--	(8.08)	6.66	5.64	--	10.19	--	--	--	--	$ 375,000	4.1754%
J.P. MORGAN	14.22%	$ 1,203,131,321													$ 5,811,081	
PEN Emerging Mkts		$ 24,167,365	(4.16)	(1.97)	14.16	7.59	8.37	17.76	23.80	25.33	(1.56)	0.09	(0.63)	0.63	$ 267,068	0.8266%
PEN Special & Strategic		$ 138,048,498	16.75	15.48	4.16	7.06	0.79	1.62	11.37	6.83	5.77	3.56	(1.52)	(0.50)	$ 1,166,108	0.9578%
PEN Alternative		$ 4,830,997	3.74	14.44	(5.64)	(2.09)	21.72	16.52	21.75	17.55	(7.24)	2.53	(11.32)	(8.67)	$ 9,924	0.1156%
PEN Greater China		$ 18,542,454	18.00	7.31	3.32	1.60	21.21	14.63	12.12	11.75	7.02	(4.61)	(2.36)	(1.96)	$ 257,839	1.1536%
PEN Greater Europe		$ 21,783,773	(10.06)	0.00	--	0.00	19.03	0.00	--	0.00	(21.04)	0.00	--	0.00	$ 507,367	8.1907%
PEN IIF		$ 103,454,777	8.92	8.48	2.54	3.23	7.13	4.90	11.01	11.02	7.47	6.37	0.27	1.42	$ 1,038,863	1.0797%
PEN Asian		$ 30,153,439	(2.67)	4.29	(0.07)	(0.07)	6.45	13.70	12.44	12.13	(4.12)	2.18	(2.35)	(1.30)	$ 593,925	2.5830%
INS Infrastructure		$ 70,785,692	8.97	8.49	6.23	6.23	7.18	4.93	6.87	6.87	12.16	3.65	0.07	0.07	$ 710,166	1.0789%
INS Income & Growth		$ 68,314,703	20.12	24.12	(1.73)	2.18	6.80	7.25	22.00	18.12	9.14	12.20	(7.41)	(4.40)	$ 782,774	1.0923%
INS JPM Budget Stab.		$ 231,118,808	0.47	--	--	1.22	0.69	--	--	0.64	0.10	--	--	0.73	$ 137,677	0.0957%
INS JPM Legacy		$ 491,930,815	0.51	--	--	1.06	0.71	--	--	0.62	0.14	--	--	0.62	$ 339,371	0.0801%

Please note all data is preliminary and subject to change

MANAGER	% Total MV (12-31-13)	Market Value 12/31/2013	Returns 1 Yr	Returns 3 Yr	Returns 5 Yr	Returns Inception	Standard Deviation (Risk) 1 Yr	Standard Deviation (Risk) 3 Yr	Standard Deviation (Risk) 5 Yr	Standard Deviation (Risk) Inception	Excess Returns[1] 1 Yr	Excess Returns[1] 3 Yr	Excess Returns[1] 5 Yr	Excess Returns[1] Inception	FEES FY13	
LA CAPITAL	7.91%	$ 669,183,643													$ 1,211,599	
PEN Enhanced		$ 220,364,788	35.95	16.63	19.02	5.13	7.46	15.56	17.90	18.00	2.84	0.33	0.43	1.01	$ 462,177	0.2654%
PEN Structured		$ 291,808,128	35.78	16.41	19.84	9.88	7.75	16.77	17.68	16.76	2.30	(0.04)	(0.55)	1.02	$ 544,481	0.2133%
INS Enhanced		$ 61,892,534	36.31	16.60	19.49	8.96	7.37	15.58	17.76	16.81	3.20	0.30	0.90	1.18	$ 94,014	0.2717%
INS Structured		$ 95,118,193	36.11	16.48	20.41	9.88	7.81	16.82	17.57	16.99	2.63	0.03	0.02	1.21	$ 110,927	0.2143%
LOOMIS SAYLES	2.43%	$ 205,217,094													$ 882,685	
PEN High Yield Bond		$ 205,217,094	6.73	9.21	19.38	9.03	5.98	9.9	13.39	13.78	(0.71)	(0.08)	0.42	0.46	$ 882,685	0.5000%
LSV	7.75%	$ 655,399,912													$ 1,753,455	
PEN Global Equity		$ 459,486,393	--	--	--	20.77	--	--	--	7.50	--	--	--	3.19	$ 334,952	0.1640%
PEN Global Equity Performance															$ 1,031,280	0.5049%
INS Large Cap Equity		$ 92,851,525	41.41	19.08	19.70	8.85	7.97	19.01	20.97	19.24	8.89	3.02	3.03	2.69	$ 158,764	0.2968%
INS Intl Equity		$ 103,061,994	25.83	9.58	13.22	5.79	11.86	17.36	22.08	21.14	3.05	1.42	0.78	0.26	$ 228,459	0.4828%
MATLIN PATTERSON	0.32%	$ 27,226,013													$ (427,782)	
PEN Fund I		$ 11,987	(6.26)	0.00	0.00	0.00	6.26	0	0	0	--	--	--	--	$ -	0.0000%
PEN Fund II		$ 1,490,463	(11.53)	(51.69)	(42.10)	(27.27)	10.97	37.49	32.72	28.9	--	--	--	--	$ (115)	-0.0071%
PEN Fund III		$ 25,723,563	9.87	42.32	13.76	7.26	14.24	52.15	49.59	44.25	--	--	--	--	$ (427,667)	-1.6642%
NORTHERN TRUST	6.87%	$ 580,875,539													$ 368,575	
PEN STIF		$ 38,019,348	0.06	0.10	0.17	3.05	0.02	0.03	0.08	1.28					$ 60,935	0.1453%
PEN Large Cap Equity Perf.		$ 110,481,138	36.88	18.20	19.30	4.14	8.97	15.66	17.90	17.97	4.49	2.02	1.36	0.37	$ 279,317	0.3215%
PEN Intl Equity (World Ex US)		$ 242,082,438	--	--	--	0.00	--	--	--	0.00	--	--	--	0.00		
PEN Emerging Markets		$ 73,325,015	(2.55)	--	--	5.50	11.81	--	--	11.03	0.05	--	--	(1.57)	$ 28,323	0.1269%
INS STIF		$ 116,967,600														
PIMCO	4.87%	$ 411,967,758													$ 11,102,281	
PEN DISCO II		$ 79,645,241	12.04	--	--	24.36	3.73	--	--	10.40	14.06	--	--	22.93	$ 910,633	0.9275%
PEN DISCO II Performance															$ 4,547,704	4.6318%
PEN Unconstrained		$ 88,809,606	(2.15)	--	--	2.85	2.36	--	--	3.96	(2.43)	--	--	2.51	$ 573,267	0.8988%
PEN MBS		$ 161,911,557	(2.13)	--	--	0.45	2.38	--	--	2.63	(0.72)	--	--	0.12	$ 264,474	0.1736%
PEN BRAVO (BRAVO II)		$ 5,000,000	--	--	--	(1.67)	--	--	--	0.00	--	--	--	(5.24)		
INS DISCO II		$ 71,601,354	12.06	--	--	24.02	3.74	--	--	10.20	14.08	--	--	22.59	$ 801,829	0.9275%
INS DISCO II Performance															$ 4,004,374	4.6319%
INS BRAVO (BRAVO II)		$ 5,000,000	--	--	--	(1.67)	--	--	--	0.00	--	--	--	(1.53)		
PRUDENTIAL	1.16%	$ 98,398,744													$ 204,186	
INS Fixed Pool		$ 98,398,744	(1.33)	5.97	9.08	6.97	3.91	3.46	4.66	4.44	0.69	2.71	4.64	2.05	$ 204,186	0.2944%
QUANTUM	0.21%	$ 17,729,799													$ 483,991	
PEN Energy Partners		$ 8,779,832	28.98	24.80	10.70	(17.18)	15.76	14.04	18.75	37.83	--	--	--	--	$ 431,985	4.8218%
PEN Energy Resources		$ 8,949,967	3.51	36.33	(17.29)	(36.64)	10.04	55.41	58.38	88.5	--	--	--	--	$ 52,006	0.5230%
RESEARCH AFF.	0.66%	$ 56,090,755													$ 138,437	
INS Small Cap Equity		$ 56,090,755	44.26	18.07	23.69	7.91	5.96	20.88	23.37	25.41	5.44	2.39	3.61	1.16	$ 138,437	0.4455%
SEI	0.99%	$ 83,707,124													$ 294,454	
PEN Small Cap Equity		$ 214,542	(1.37)	47.09	34.54	10.06	9.98	216.76	167.04	107.64	(40.20)	31.42	14.45	1.87	$ -	0.0000%
PERS Prefunded Health		$ 83,492,582	19.23	10.98	13.89	7.69	3.65	9.94	12.32	10.37	2.12	0.92	1.47	--	$ 294,454	0.5040%

Please note all data is preliminary and subject to change

MANAGER	% Total MV (12-31-13)	Market Value 12/31/2013	Returns 1 Yr	Returns 3 Yr	Returns 5 Yr	Returns Inception	Standard Deviation (Risk) 1 Yr	Standard Deviation (Risk) 3 Yr	Standard Deviation (Risk) 5 Yr	Standard Deviation (Risk) Inception	Excess Returns[1] 1 Yr	Excess Returns[1] 3 Yr	Excess Returns[1] 5 Yr	Excess Returns[1] Inception	FEES FY13	
STATE STREET	**2.77%**	**$ 233,941,146**													**$ 3,301**	
PEN Domestic Fixed Pool		$ 61,023,451	--	--	--	(5.25)	--	--	--	0.85	--	--	--	(0.01)	$ 992	0.0076%
INS Fixed Pool		$ 172,917,695	--	--	--	0.30	--	--	--	0.41	--	--	--	(0.02)	$ 2,309	0.0076%
TIR	**2.96%**	**$ 250,615,246**													**$ 1,279,438**	
PEN Teredo		$ 73,052,113	(4.61)	1.40	4.56	10.22	8.73	7.09	7.22	10.89	(14.29)	(4.88)	1.88	3.29	$ 457,494	0.5943%
PEN Springbank		$ 120,392,935	(2.98)	(3.35)	(4.97)	7.97	1.57	2.70	7.11	20.92	(12.66)	(9.64)	(7.66)	(0.54)	$ 314,322	0.2561%
INS Timber		$ 57,170,198	5.19	0.58	2.37	2.25	6.73	5.29	6.05	5.90	8.38	(4.26)	(3.80)	(2.32)	$ 507,622	0.8341%
UBS	**1.22%**	**$ 103,601,569**													**$ 285,672**	
PEN Intl Fixed Income		$ 103,601,569	(4.35)	1.37	2.95	6.79	6.97	5.48	8.38	9.07	(1.27)	(0.36)	(0.56)	--	$ 285,672	0.2985%
VANGUARD	**0.30%**	**$ 25,492,527**													**$ 45,054**	
INS Intl Equity Pool		$ 25,492,527	30.78	7.59	17.73	12.82	9.45	19.67	24.39	22.75	6.74	0.63	1.99	1.30	$ 45,054	0.4200%
WELLINGTON	**1.02%**	**$ 85,921,548**													**$ 561,118**	
PEN Intl Equity		$ 85,921,548	36.35	13.75	21.31	12.44	10.55	16.96	22.41	21.69	12.30	6.80	5.56	1.17	$ 561,118	0.8534%
WELLS	**4.46%**	**$ 376,922,085**													**$ 613,148**	
INS Fixed Income		$ 376,922,085	-0.75	6.73	10.99	7.31	4.41	3.78	6.1	5.51	1.30	1.26	0.56	0.74	$ 613,148	0.2187%
WESTERN	**8.08%**	**$ 683,215,330**													**$ 894,348**	
PEN Domestic Fixed Income		$ 109,189,859	(1.99)	3.15	7.34	7.46	2.68	2.78	5.00	5.10	(0.57)	0.73	3.65	0.47	$ 182,317	0.1771%
INS Fixed Income		$ 375,615,203	(1.03)	5.21	9.33	7.40	2.68	2.87	4.90	4.91	1.00	1.95	4.89	0.86	$ 376,703	0.1794%
INS TIPS		$ 198,410,268	(4.95)	3.71	5.18	4.18	8.33	5.78	6.21	5.97	(1.76)	(1.13)	(0.98)	(1.25)	$ 335,329	0.1771%
Total MV 12-31-13		**$ 8,459,353,811**														**0.6272**

[1] *Excess Returns for Private Equity are assumed to be zero given the absence of a widely accepted benchmark for these diverse strategies.*

No Longer Active 12-31-13		
PEN Clifton - Developed Int'l	$ 172,768	0.0874%
PEN LSV - Domestic Equity	$ 441,745	0.3563%
PEN LSV - Int'l Equity	$ 286,530	0.4875%
PEN State St. - Developed Int'l	$ 248,591	0.5383%
PEN Panagora - Emerging	$ 116,010	0.6981%
PEN Pimco Distressed	$ 25,652	
PEN Pimco Perf.	$ 2,049,978	
PEN UBS - Emerging	$ 291,475	0.9266%
PEN Calamos	$ 386,180	0.7187%
PEN BND F.I.	$ 24,323	0.0672%
INS BND F.I.	$ 56,395	0.0667%
INS Babson B Loans	$ 5,886	0.1681%

Please note all data is preliminary and subject to change

Agenda Item III. C.

State Investment Board

Watch List Recommendations

March 28, 2014

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Watch List Recommendations

Western Asset Management Company ("WAMCO") – After an onsite visit and extended discussion with the consultant community, Staff **recommends** a search be conducted for the WAMCO MBS mandate given the recent "Regulatory Settlement" and significant management turnover in this area. Staff continues to **recommend** the Global Inflation Linked and U.S. Core mandate remain on the watch list. The latter mandate has been a top performer for over 20 years.

Mandates	Benchmark	Inception Date	SI Returns	SI vs Index	5Y Returns	5Y vs Index	3Y Returns	3Y vs Index	1Y Returns	1Y vs Index	Market Value
US MBS	Barclays U.S. MBS USD Unhedged Bond	3/31/2012*	1.23%	-0.07%	N/A	N/A	N/A	N/A	0.23%	-0.40%	$ 115,307,524
Global Inflation Linked	Barclays World Govt Inflation-Linked	5/18/2004	4.38%	-0.44%	6.59%	0.81%	3.90%	-0.15%	-0.33%	0.31%	$ 234,120,386
US Core	Barclays U.S. Aggregate	7/2/1990	6.68%	0.90%	10.10%	4.97%	5.66%	1.83%	1.51%	1.63%	$ 440,220,949
											$ 789,648,859

Pacific Investment Management Company ("PIMCO") – After positive onsite meetings with our portfolio managers and PIMCO's new CEO (Douglas Hodge), Staff continues to **recommends** that all PIMCO strategies remain on the watch list until further notice including Agency MBS ($172 million), Unconstrained Bond ($93 million), DiSCO II ($154 million) and BRAVO II (11 million).

North Dakota State Investment Board			Performance[1]					Total Estimated Fees		Fee Schedule
	Inception Date	Target Return	YTD	1 year	3 year	5 year	S.I.	FY 2013[2]	Est. FY 2014[3]	
Agency MBS (gross)	April 13, 2012	Benchmark + 0.25%	1.9%	0.0%	N/A	N/A	1.3%	$ 264,474	$ 297,105	18 bps on first $300mm, 16.5 bps on next $300mm, 15 bps thereafter
Unconstrained Bond Fund (gross)	April 24, 2012	LIBOR + 3% to 4%	1.3%	-1.1%	N/A	N/A	3.4%	$ 566,967	$ 614,784	60 bps on first $200mm, 55 bps thereafter[2]
DiSCO II (net)	October 7, 2011	10% to 12% (net)	2.0%	9.8%	N/A	N/A	23.5%	$ 11,783,210	$ 5,108,604	Mgmt fee of 0.75% on NAV. Admin fee is equal to the aggregate of 20 bps of the Fund's NAV for the first $500mm fund and 15 bps of the Fund's NAV thereafter. 15% carried interest above 1 month LIBOR plus mgmt/adm fees. Subject to a high watermark.
BRAVO II (net)[5]	March 19, 2013	15% to 20% (net IRR)	N/A	N/A	N/A	N/A	35.4%	$ -	$ 179,855	1.36%[6] and 0.20% mgmt and admin fees, respectively, on invested capital. 20% carried interest above 8% hurdle

Loomis, Sayles ("Loomis") – After a meeting in our offices and discussion with Callan, Staff **recommends** that Loomis remain on the watch list until short-term performance improves.

Note: Please refer to Callan's comments on our watch list recommendations which follow.

SIB Managers Currently Under Review

Manager	Pool	Review Inception	Reason	Status
Loomis Sayles	Pension	Oct-12	Full Discretion co-PM Kathleen Gaffney departure	Ongoing review of two additions to Full Discretion team and Dan Fuss succession plan.
PIMCO	Pension, Insurance	Feb-14	Personnel changes – Unconstrained Bond PM Chris Dialynas sabbatical, co-CIO Mohamed El-Erian departure	Recommend a formal review with findings and recommendation to be reported at a subsequent meeting.
Western Asset	Pension, Insurance	Feb-14	Concerns regarding internal controls stemming from trading practices cited in recent SEC and DOL settlements	Recommend a formal review with findings and recommendation to be reported at a subsequent meeting.

North Dakota Pension Trust

Loomis Sayles: Performance and Personnel

- Loomis Sayles manages over 90% of the Pension Trust's high yield bond allocation. The manager underperformed in 2013. While longer term results are ahead of benchmark for the five years ended 12/31/13, +19.4% versus +19.0%, the strategy's volatility is relatively high.
- Additionally, we make note of the following personnel issues:
- **10/19/2012** - Loomis, Sayles & Company, L.P. recently announced organizational changes which bring equity and fixed income groups under the leadership of Jae Park, Chief Investment Officer. These changes were effective as of October 15, 2012. Park has been CIO for Fixed Income since 2002 and will now be responsible for all investment activity (equity and fixed-income) at Loomis Sayles.
- **10/23/2012** - Eaton Vance Management announced the addition of Kathleen Gaffney as Vice President and Co-Director of the Investment Grade Fixed Income Team. Gaffney joined Eaton Vance from Loomis, Sayles & Company, where she had worked for 28 years on the Loomis Multisector Fixed Income group. Gaffney is expected to contribute to existing strategies and to newly created multi-sector fixed income products.
- **01/30/2014** - Loomis, Sayles & Company announced that Brian Hess joined as a global markets fixed income strategist on the Full Discretion Team. He will report directly to Elaine Stokes and Matt Eagen, the co-heads of the Full Discretion Team. He was previously an associate portfolio manager with Brandywine Global Investment Management (which manages a global bond portfolio for the SIB).

North Dakota Pension Trust

Pacific Investment Management Company (PIMCO): Organization and Personnel

- PIMCO manages four separate mandates for the NDSIB Pension Trust. In total, the assets under PIMCO's control amounted to nearly $335.4 million as of 12/31/14. This is over 42% of the Pension Trust's overall domestic fixed income allocation. Two of their strategies significantly underperformed in 2013. MBS: (2.13%) vs (1.41%); Unconstrained: (2.14%) vs +0.28%.
- Take a deep breath as we make note of the following personnel issues relative to PIMCO:
- **10/17/2013** – Brigitte Posch, formerly head of emerging markets corporate bonds at PIMCO, joined Babson Capital Management (a bond manager on the Insurance Trust). Posch and Ricardo Androgue -- previously with Cabezone Investment Management and Wellington – will manage Babson's new emerging market debt team.
- **12/13/2013** - PIMCO announced that the lead portfolio manager for the 'Unconstrained Bond Fund," Chris Dialynas, will take an open-ended sabbatical beginning in April of 2014. Bill Gross, Chief Investment Officer, took over the Unconstrained Bond Fund as of December 2013. Dialynas has also been the lead manager on many institutional separate accounts. Dialynas is expected to remain active on the PIMCO Investment Committee and participate in their secular and cyclical forums during his sabbatical.
- **01/22/2014** –Mohamed El-Erian, Chief Executive Officer and Co-Chief Investment Officer of PIMCO, is leaving the firm effective mid-March, 2014. El-Erian will remain an advisor to PIMCO's parent company, Allianz, but did not announce any other plans. The following personnel announcement followed the release of El-Erian's planned departure:

North Dakota Pension Trust

Pacific Investment Management Company (PIMCO): Organization and Personnel

- **January 22, 2014** – the following personnel announcements were also released:
  - **Doug Hodge**, Chief Operating Officer, was elected CEO by PIMCO's Managing Directors
  - **Jay Jacobs**, the firm's Global Head of Talent Management, was elected President
  - **Bill Gross** remains CIO
  - **Andrew Balls** and **Daniel Ivascyn** were appointed Deputy CIOs
  - **Craig Dawson** becomes Head of Strategic Business Development.
- Balls is based in London and heads up PIMCO's European team, while Ivascyn is the head of PIMCO's mortgage credit team. Finally, Craig Dawson, who is currently Head of PIMCO Germany, Austria, Switzerland, and Italy, will become Head of Strategic Business Development.
- **01/30/2014** – Additional personnel announcements rode the wake of the prior week's news of Mohammed El-Erian's departure. In addition to the previously announced Deputy Chief Investment Officer appointments of Dan Ivascyn and Andrew Balls, four additional professionals have been appointed to the position of Deputy CIO:
  - **Mark Kiesel**, Head of Corporate Bond Portfolio Management
  - **Scott Mather**, Head of Global Portfolio Management
  - **Mihir Worah**, Head of Real Return Portfolio Management
  - **Virginie Maisonneuve**, Global Head of Equities
- The six Deputy CIOs, along with CIO Bill Gross, will rotate chairman responsibility for the firm's Investment Committee on a daily basis.

North Dakota Pension Trust

Pacific Investment Management Company (PIMCO): Organization and Personnel

- PIMCO also announced the return of **Sudi Mariappa** as a Generalist Portfolio Manager in the Newport Beach office. Mariappa was previously with PIMCO from 2000 to 2011 before leaving to join a London-based hedge fund.
- PIMCO revealed that **Rich Clarida**, Ph.D., Executive Vice President, will lead PIMCO's secular forums, a role previously held by El-Erian. Clarida was previously Assistant Secretary of the Treasury and Chairman of the economics department at Columbia University.
- Two additional departures were announced by the firm on January 22, 2014.
  - **Mark Seidner**, a Managing Director, Portfolio Manager, and member of the Investment Committee, will depart the firm at the end of the month. Seidner joined PIMCO in 2009 and previously worked with El-Erian at Harvard.
  - **Chuck Lahr**, a Managing Director and Equity Portfolio Manager, is also departing.
- PIMCO has a very deep bench of investment talent. Nevertheless, in light of these significant senior level changes, we encourage NDSIB to place PIMCO under scrutiny. Callan is closely observing the performance of the accounts and the stability of the organization. We will alert your investment staff to any issues of which we become aware as these personnel changes take hold and their effects flow through to the investment side.

Callan *

North Dakota Pension Trust

Western Asset Management Company (WAMCO): Compliance breach and personnel

- Western Asset Management Company (WAMCO) manages a little under $110 million in a mortgage-backed securities mandate for NDSIB.
- **1/27/14** -- Western Asset Management Company ("WAMCO") announced that two joint investigations by the Securities and Exchange Commission ("SEC") and the US Department of Labor ("DOL") had been concluded. These investigations resulted in aggregate fines of approximately $3.6M, and compensatory payments to impacted clients of approximately $17.4M.
- The first of the two regulatory issues involved the purchase of non-ERISA eligible securities within ERISA accounts managed by WAMCO. These particular prohibited purchases occurred as late as October 2008 but WAMCO failed to notify affected clients until August 2010.
- The second issue regards cross trades initiated among client accounts between 2007 and 2010. The SEC determined that WAMCO "arranged dealer-interposed cross trade transactions . . . effected between two registered investment companies ("RICs") or between RIC and RIC-affiliated client accounts" in violation of the Investment Company Act.
- **09/11/2013** - WAMCO announced that Steve Fulton, head of agency mortgage-backed securities (MBS), would retire on September 30, 2013. Fulton was replaced by Anup Agarwal. Agarwal joined WAMCO as head of structured products in July 2013.
- Callan encourages the NDSIB to engage in due diligence to determine whether or not WAMCO's breaches are cause for dismissal. While unrelated to the SEC action, the personnel change merits scrutiny. Callan is sharing our research and experience with RIO investment staff.

*Callan

North Dakota State Investment Board

March 19, 2014

Kevin Ehrlich Derek C. Fan James J. Flick Paul E. Wynn

Agenda

North Dakota State Investment Board

- Mr. David Hunter, Executive Director & Chief Investment Officer
- Mr. Darren Schulz, CFA, Deputy Chief Investment Officer

Wednesday, March 19, 2014

- Antarctica Conference Room, 5th Floor
- Host: Derek C. Fan, Client Service Executive

9:40 am	***Pick-up LAX by WAMCO***
11:00 – 11:45 am	***Compliance Overview*** *Kevin Ehrlich, Manager, Regulatory Affairs*
11:45 – 12:30 pm	***Portfolio Review (Working Lunch)*** *Paul E. Wynn, Portfolio Manager*
12:30 – 1:00 pm	***Organizational Overview*** *James J. Flick, Director of Global Client Service & Marketing*
1:15 pm	***Pick-up by NRN Car Service*** *Confirmed by Shake* *Ph: 818-541-9003*

Biographies

KEVIN EHRLICH

16 Years Experience

- Western Asset Management Company – Manager, Regulatory Affairs, 2004–
- Legg Mason Wood Walker – Associate General Counsel, 2000–2004
- U.S. Securities and Exchange Commission – Attorney, 1997–2000
- *Villanova University School of Law, J.D.*
- *Villanova University College of Commerce and Finance, M.B.A.*
- *John Carroll University, B.S.B.A.*

DEREK C. FAN

13 Years Experience

- Western Asset Management Company – Client Service Executive, 2010-
- PIMCO – VP, Client Service Account Manager, 2007-2010
- Study Solutions – Founder and Principal, 2004-2007
- Triage Consulting Group – Consultant, 2001-2004
- *Kellogg School of Management, Northwestern University, M.B.A.*
- *University of California, Los Angeles, B.A.*

JAMES J. FLICK

27 Years Experience

- Western Asset Management Company – Director of Global Client Service & Marketing, 1998–
- Transamerica Investment Services – Portfolio Manager, 1996–1998
- Lehman Brothers Inc. – Senior Vice President, Fixed Income, 1994–1995
- J.P. Morgan Securities, Inc. – Senior Vice President, Fixed Income, 1993–1994
- Citicorp Securities Inc. – Vice President, Fixed Income, 1990–1992
- Goldman, Sachs & Co. – Associate, Fixed Income, 1987–1990
- *University of Chicago, M.B.A.*
- *Ohio State University, B.S.*

PAUL E. WYNN

32 Years Experience

- Western Asset Management Company – Portfolio Manager, 1992–
- Morgan Grenfell – Portfolio Manager, 1982–1992
- *Keele University, B.S.*

Note: Western Asset experience reflects current position title and hire date.

Relationship Summary

Account Name	Mandate	Inception Date	AUM
NDSIB - Insurance Trust	US - Core	7/2/1990	$ 440,220,949.24
NDSIB - Pension Trust	US - MBS	7/1/1986	$ 115,307,523.62
NDSIB - Insurance Trust	Global Inflation Linked	5/18/2004	$ 234,120,386.21

AUM as of 28 Feb 14

The NDSIB Pension Trust portfolio (a/c 440) transitioned from a US Core mandate to a US Mortgage mandate in March 2012

Table of Contents

Organizational Update

Western Asset Management

Western Asset is a global investment management firm committed to understanding the needs of each client, identifying investment solutions and delivering superior long-term investment results

We Believe in Value

Investment Philosophy

Long-term, fundamental value discipline

- Bottom-up
- Top-down

Diversified strategies

- Depth of resources
- Global

Integrated analytics and risk management

- Relative value analysis
- Transparency and communication

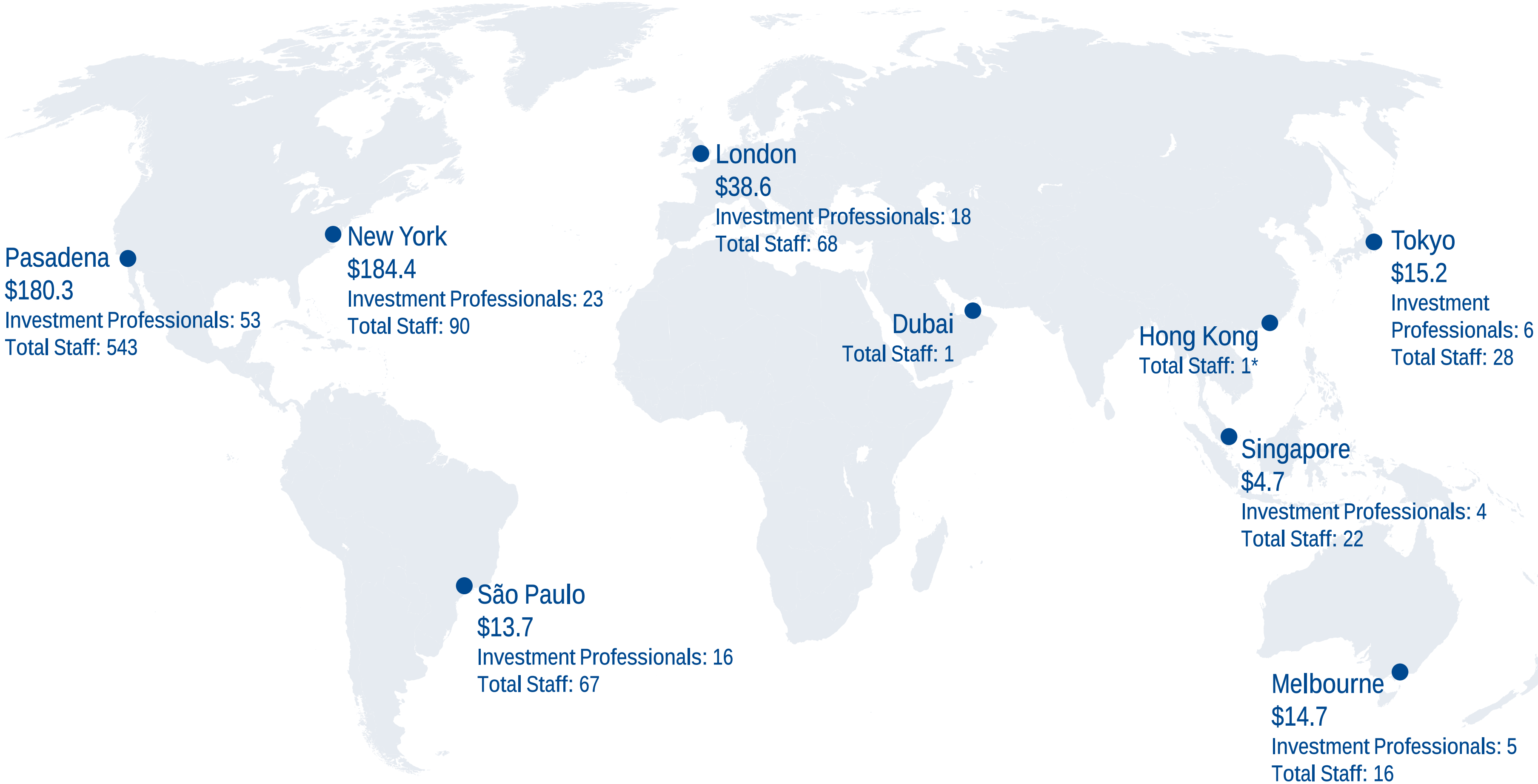
Global Breadth and Local Depth

December 31, 2013

Total AUM: $451.6 billion

8 Countries

Total Staff: 835



Assets under management in USD (billions)
**Splits time between Hong Kong and Singapore offices*

WESTERN ASSET

Investment Solutions

Objective-Driven Investing

Preserve Principal

Money Markets
Limited Duration
GNMA
Agency MBS

Diversify Globally

Global Sovereign
Infrastructure Debt
Global Core/Core Full Discretion
Global Credit
Global Sovereign Total Return

Enhance Income

Short Duration High Income
Emerging Markets
High-Yield
Diversified High Income
Structured Products/REIT/CLO

Protect From Rising Rates

Adjustable Rate
Bank Loans

Core Fixed-Income

Intermediate
Core
Core Full Discretion
Investment-Grade Credit

Increase Alpha

Global Credit Absolute Return
Macro Opportunities

Protect From Inflation

US TIPS
Global Inflation-Linked
Currencies

Generate Total Return

Total Return Unconstrained
Global Multi-Sector
Dynamic Fixed-Income

Hedge Liabilities

Long Duration
Long Credit
LDI
Tail Risk Protection

Investment Management Organization*

S. Kenneth Leech
Co-Chief Investment Officer

Stephen A. Walsh
Co-Chief Investment Officer

Gavin L. James
Director of Global Portfolio Operations

Europe

London
Andrew J. Belshaw
Europe Portfolios
UK Portfolios

Americas

New York / Pasadena

Dennis J. McNamara
Insurance
Liquidity
Limited Duration
Long Duration
Municipals
TIPS

Carl L. Eichstaedt
Broad Market Portfolios

Christopher Orndorff
Multi-Sector Portfolios
& Derivatives

Michael C. Buchanan
Global Credit

Keith J. Gardner
Emerging Markets

Anup Agarwal
Mortgage-Backed
Asset-Backed

Rajiv Sachdeva
Quantitative Analysis

São Paulo

Paulo E. Clini
Brazil Fixed-Income
Brazil Equities

Asia-Pacific

Tokyo
Kazuto Doi
Japan Portfolios

Singapore
Chia-Liang Lian
Asia Portfolios

Melbourne
Anthony C. Kirkham
Australia Portfolios
New Zealand Portfolios

As of 28 Feb 14
**Illustrates direct-reporting only and does not represent the entire investment management team.*

Committed to Excellence in Client Service

Representative Client List

Corporate	Public	Multi-Employer / Union	Insurance
Alcoa Inc.	Arkansas Local Police and Fire Retirement System	1199 SEIU National Benefit Fund	AXA
Alliant Techsystems Inc.	Arkansas Teacher Retirement System	Alaska Electrical Trust Funds	Blue Cross Blue Shield of Massachusetts
Allied Domecq Pension Fund	Baltimore County (MD) Employees Retirement System	Bert Bell / Pete Rozelle NFL Player Retirement Plan	Catalina Holdings (Bermuda) Ltd
American Cast Iron Pipe Company	California State Teachers' Retirement System	Boilermaker Blacksmith National Pension Trust	Great-West Life & Annuity Insurance Company
ArcelorMittal USA Inc.	City of Grand Rapids	Directors Guild of America-Producer Pension and Health Plans	Health Care Service Corporation
AT&T Investment Management Corporation	City of Orlando	IUOE Employers Construction Industry Retirement Plan, Locals 302 and 612	Highmark Health Services
Bayer Corporation	East Bay Municipal Utility District	Line Construction Benefit Fund	Maryland Automobile Insurance Fund
Campbell Soup Company	Employees' Retirement System of the State of Rhode Island	Major League Baseball Players Benefit Plan	Oil Investment Corporation Ltd.
Cathay Securities Investment Trust	Fife Council Pension Fund	National Education Association of the United States	Reliance Standard Life Insurance Company
Chrysler LLC	Fonds de compensation AVS	New England Healthcare Employees Union, District 1199, AFL-CIO	United Services Automobile Association
CNH Global N.V.	Fresno County Employees' Retirement Association	Teamsters Union Local No. 52 Pension Fund	WellPoint, Inc.
Consolidated Edison Company Of New York, Inc.	Gloucestershire County Council	UAU Local No. 290 Plumber, Steamfitter & Shipfitter Industry Pension Trust	**Healthcare**
Consolidated Rail Corporation	Government of Bermuda Public Funds	United Food and Commercial Workers Union Local 919	Ascension Investment Management
Crown Cork & Seal Company, Inc.	Hampshire County Council	Western States Office & Professional Employees Pension Trust	Baptist Healthcare System, Inc.
Delta Air Lines, Inc.	Indiana State Treasurer's Office	**Eleemosynary**	Baylor Health Care System
Energy Transfer Partners LP (formerly Sunoco, Inc.)	Iowa Public Employees' Retirement System	Abilene Christian University	Catholic Health Initiatives
Galileo & Worldspan U.S. Legacy Pension Plan Trust	Kansas Public Employees Retirement System	Abington Memorial Hospital	Children's Hospital of New Orleans
Graphic Packaging International Incorporated	Korea Investment Corporation	Baha'i' World Centre	CHRISTUS Health
Hawaiian Telcom	Los Angeles County Employees Retirement Association	Battelle Memorial Institute	Lehigh Valley Hospital
International Paper Company	Marin County Employees' Retirement Association	Bill & Melinda Gates Foundation Trust	Medica
John Lewis Partnership Pensions Trust	Minnesota State Board of Investment	Board of Trustees of Southern Illinois University	NorthShore University HealthSystem
LSI Logic Corporation	Nevada Public Employees Retirement System	Commonfund	OhioHealth Corporation
Macy's, Inc.	New Jersey Transit	Creighton University	Pinnacle Health System
McKesson Corporation	North Dakota State Investment Board	Domestic & Foreign Missionary Society ECUSA	Providence Health and Services
National Grid USA	Ohio Police & Fire Pension Fund	E. Rhodes & Leona B. Carpenter Foundation	St. George Corporation
Nestle USA, Inc.	Orange County Transportation Authority	Indiana University	**Sub-Advisory**
Nisource, Inc.	Oregon Investment Council	Saint Louis University	DIAM Co., Ltd.
PCS Administration (USA), Inc	Public Employee Retirement System of Idaho	Salk Institute for Biological Studies	GuideStone Capital Management
Pensioenfonds Horeca & Catering	Public School Teachers' Pension and Retirement Fund of Chicago	San Francisco Foundation	Highbury Pacific Capital Corp.
PPG Industries	Salt River Project Agricultural Improvement and Power District	The Rotary Foundation of Rotary International	Investeringsforeningen Gudme Raaschou
Southern California Edison	School Employees Retirement System of Ohio	United Negro College Fund	KOKUSAI Asset Management Co., Ltd.
Stichting Pensioenfonds DSM-Nederland	Seattle City Employees Retirement System	University of Illinois	Legg Mason, Inc.
Sumitomo Mitsui Asset Management Company, Limited	Surrey County Council	University of Miami	Mitsubishi UFJ Asset Management Co., Ltd.
The Dun & Bradstreet Corporation	Tennessee Valley Authority	University of Southern California	Morgan Stanley Consulting Group
ThyssenKrupp North America, Inc	Ventura County Employees' Retirement Association	University of Wisconsin Foundation	Quaestio Investments S.A.
Unilever United States, Inc.	Virginia Retirement System	Voelcker Foundation	Russell Investment Group
Unisys Corporation	Wiltshire Council	Washington College	SEI Investments Management Corporation
YMCA Retirement Fund	Wyoming Retirement System	Washington State University	Shinko Asset Management Co., Ltd.

As of 31 Jan 14. Please see the Representative Client List Disclosure in the Appendix for more information. All have authorized the use of their names by Western Asset for marketing purposes. Such authorization does not imply approval, recommendation or otherwise of Western Asset or the advisory services provided.

Global Inflation-Linked Market Review

Outlook

Outlook

- Global growth modest (but set to improve)
- Moderate US growth to continue
- European recession moderating
- China’s soft landing coming into evidence
- Less fiscal retrenchment, less monetary accommodation

Inflation-linked Strategy

- Long German real yields
- Short a mixture of real and nominal UK/US yields
- Long UK breakevens
- Curve preference for long-dated TIPS
- Short JPY and EUR
- Modest exposure to Emerging FX/bonds

Risks

- Flight to quality on geopolitical risks
- US Data remains weak post weather effects
- Japan fails to push policy further
- Market concerns over China rise

The above reflects current opinions of Western Asset Management.

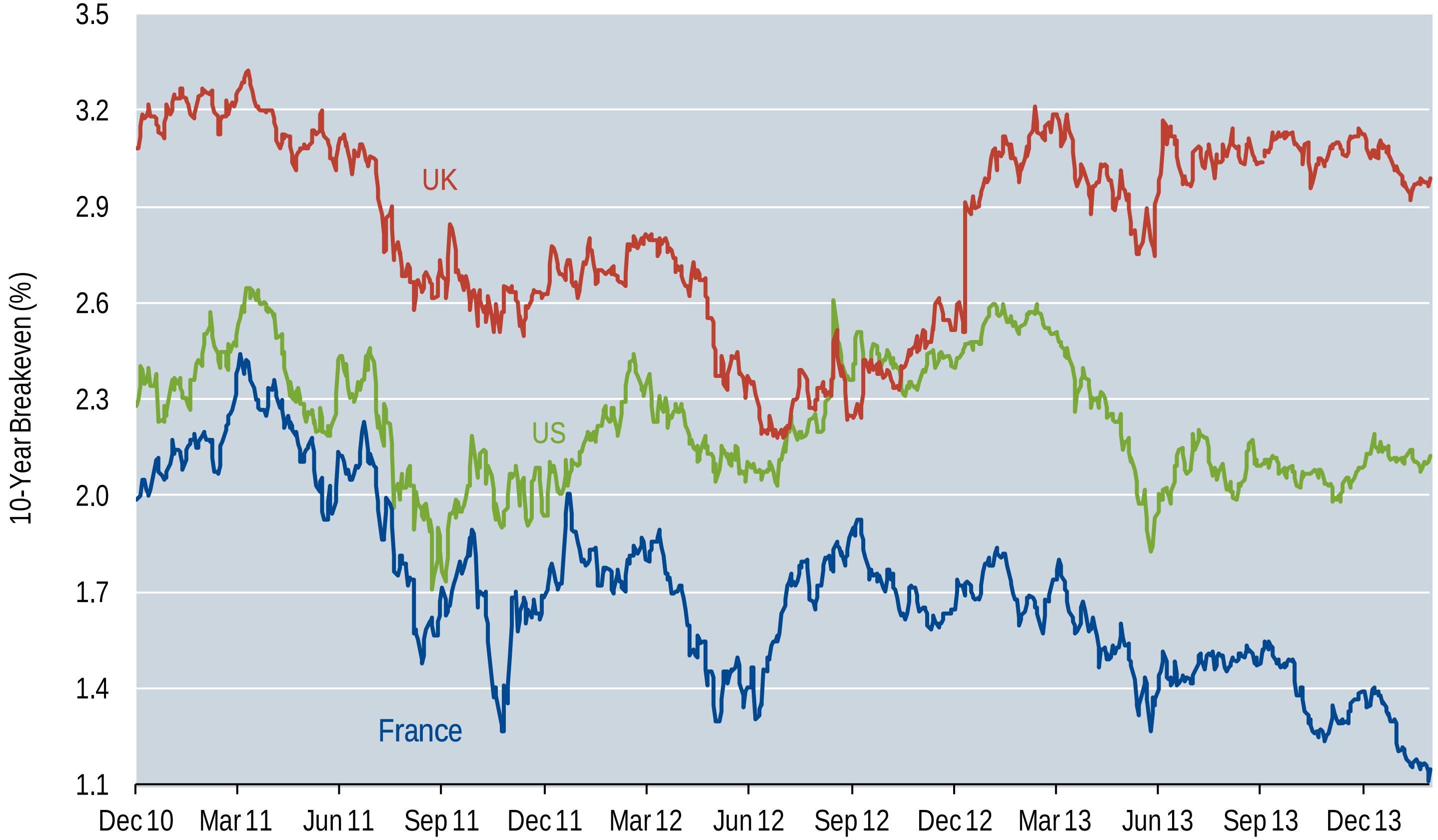
Main Risk Positions

Country	Strategies	Position	Rationale	Risks
UK	Curve	Long 15yr versus 5yr/20yr	Index event (15yr drop out of the 15+)	Already priced?
	Duration	Underweight reals and nominals	growth momemtum remains strong	Unsustainable
	Breakeven	Long 10yr Breakevens	RPI to rise versus CPI	Housing market weakness
US	Duration	Short 5-10yr Nominals	Weather effects mask ongoing improvement	Sustained data weakness
	Curve	Bias towards 30yr real yields	30yr real yields consistent with moderate growth	Policy hikes pushed back
Europe	Duration	Long German real yields	Europe needs negative real yields to aid recovery	ECB inaction
	Sector	Short French OATi versus OATei	French inflation to weaken versus Euro basket	Livret A demand
FX	FX	Underweight EUR vs USD	Fragile European recovery/export sensitivity	ECB allows real tightening
		Underweight JPY vs USD	Japan reflation/Fed Taper	Deflation persists in Japan
		Underweight GBP vs MEX/BRL	Modest growth/yield pick up	Policy hikes moved forward

The above reflects current opinions of Western Asset Management.

Sector

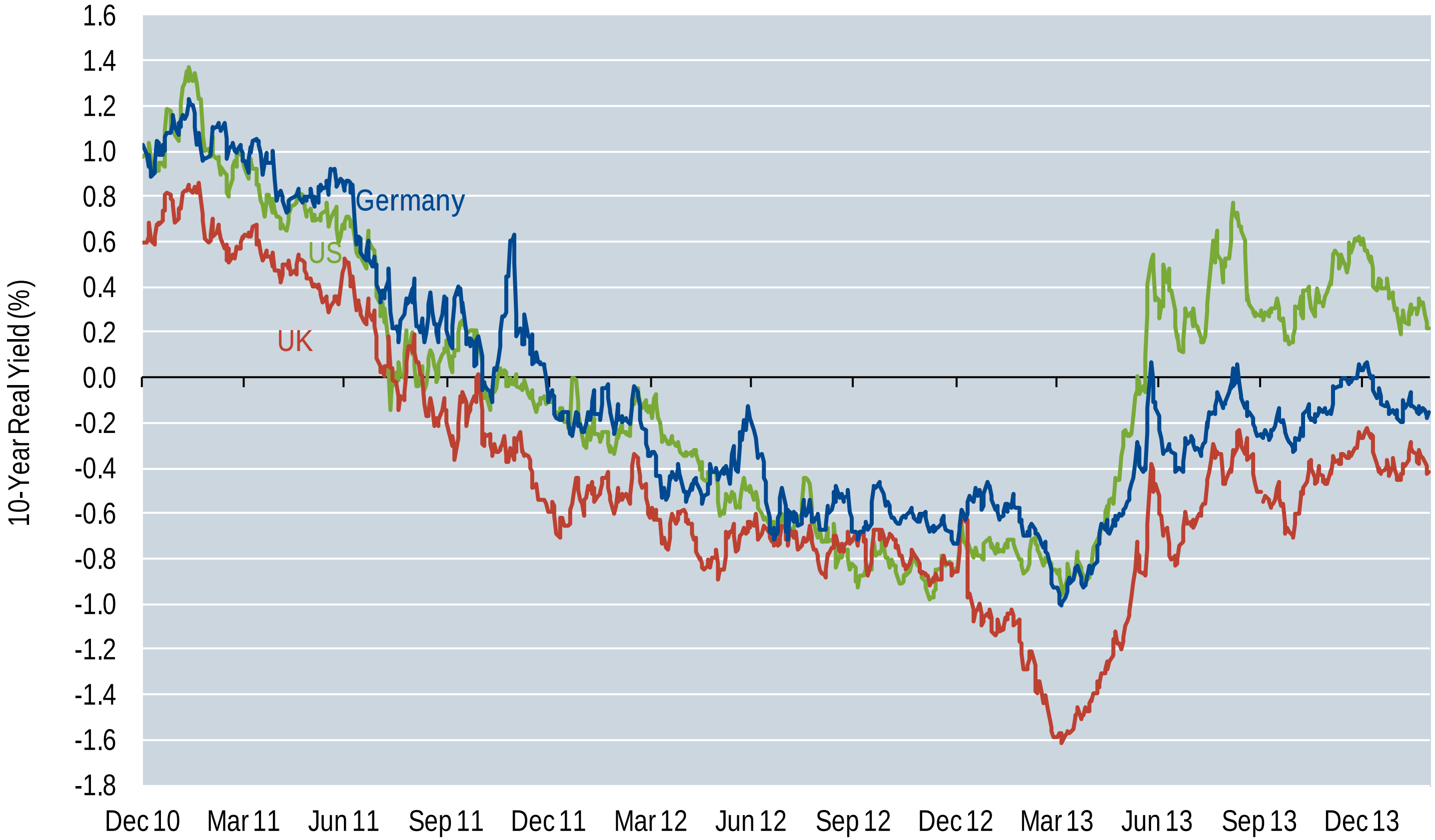
Breakevens



Source: Barclays, Western Asset As of 28 Feb 14

Duration

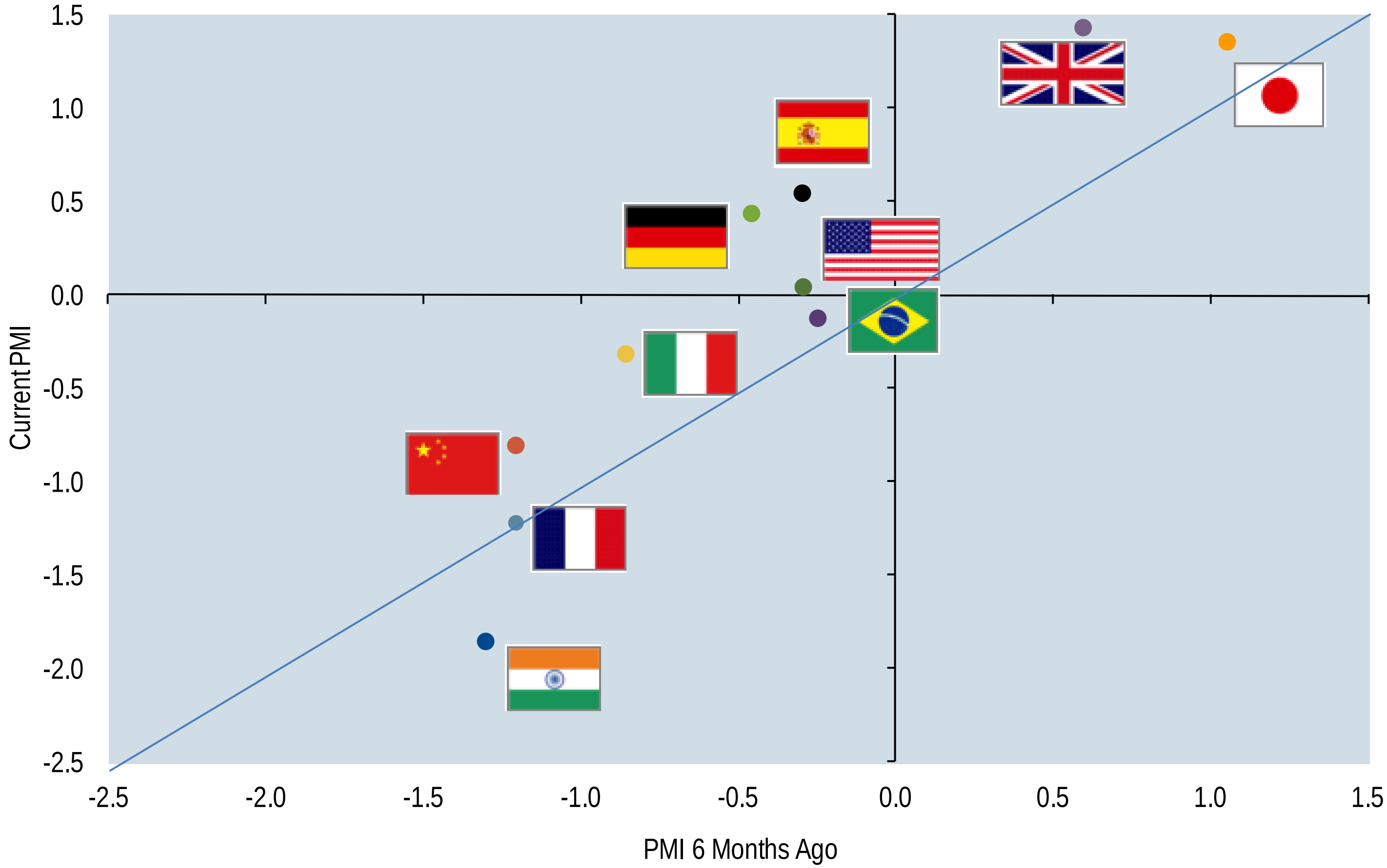
Real Yields



Source: Barclays, Western Asset As of 28 Feb 14

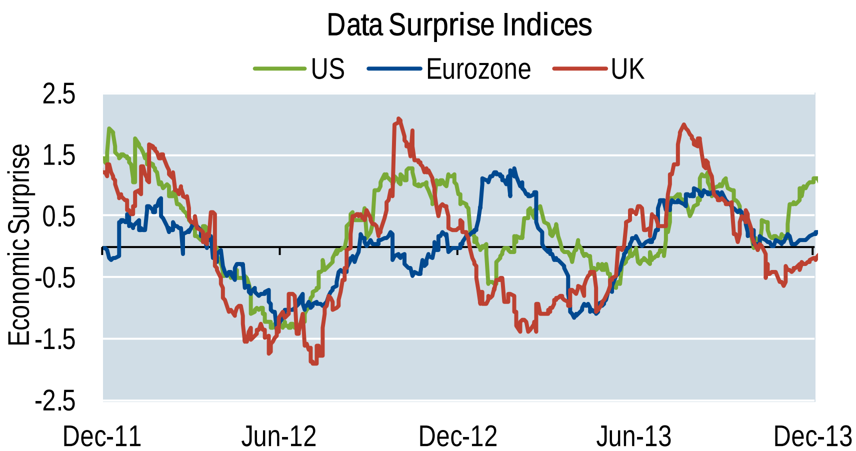
Growth Outlook

Regional Trends



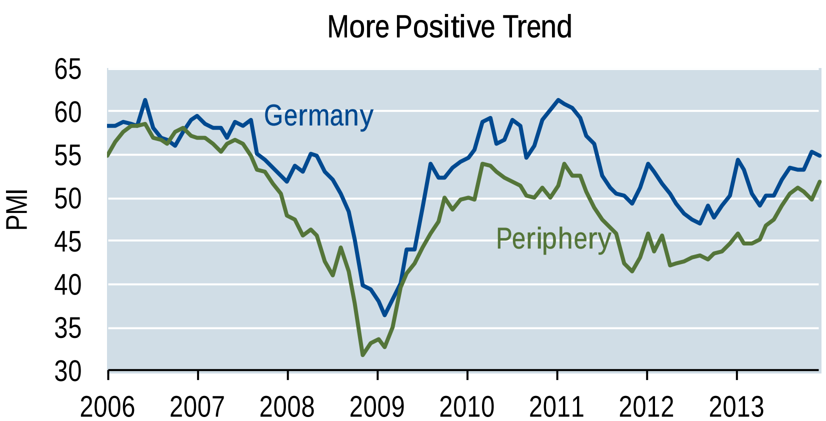
Source: Bloomberg, Western Asset. As of 31 Dec 13

Growth Outlook

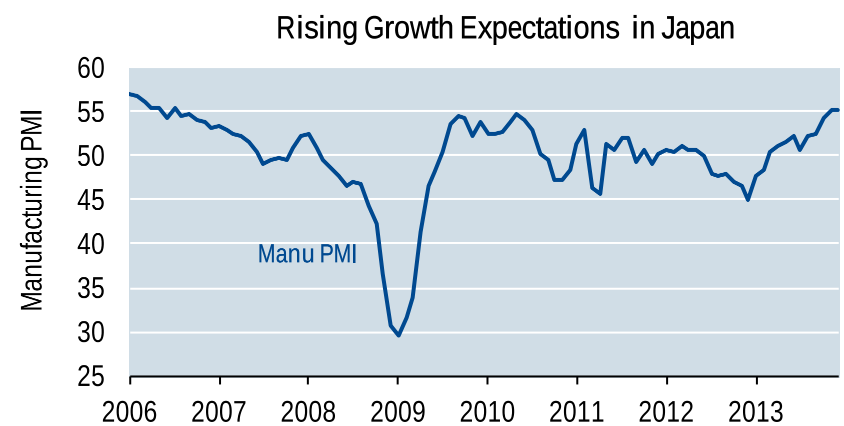


Source: Citigroup, Bloomberg and Western Asset. As of 31 Dec 13

Source: Bloomberg. As of 31 Dec 13

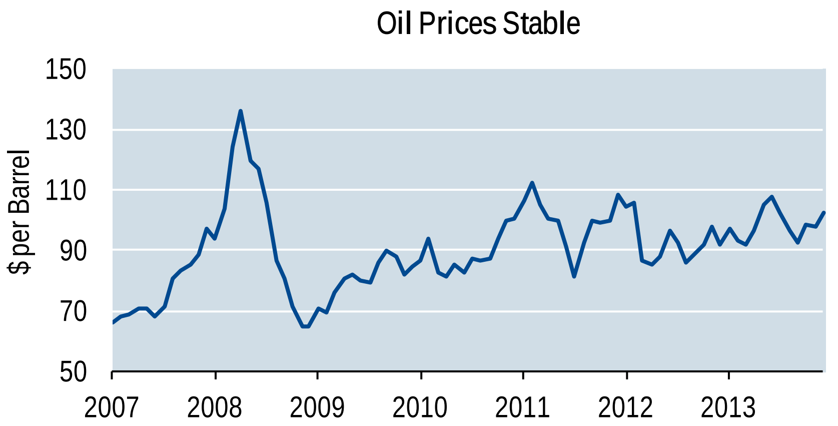


Source: Bloomberg. As of 31 Dec 13

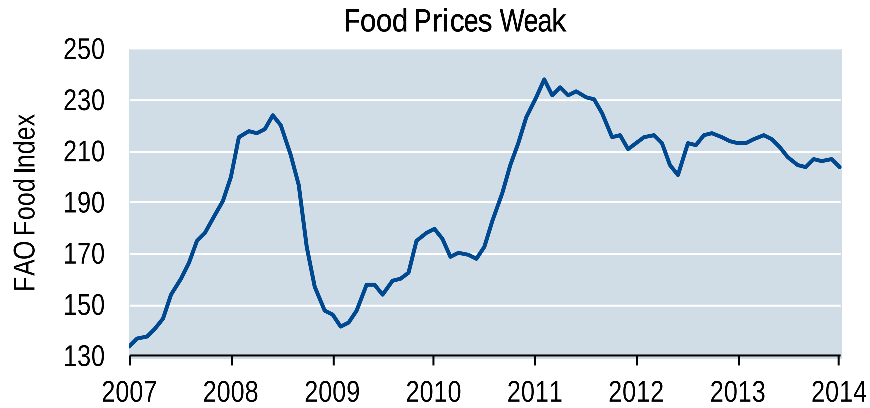


Source: Bloomberg. As of 31 Dec 13

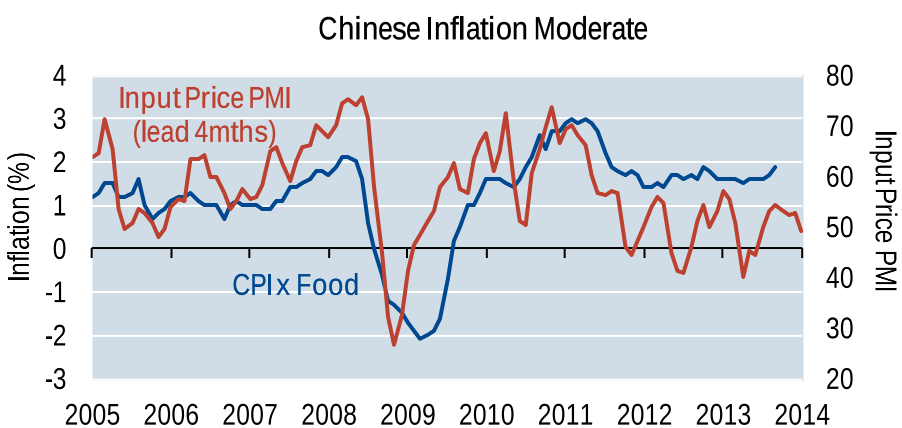
Inflation Outlook



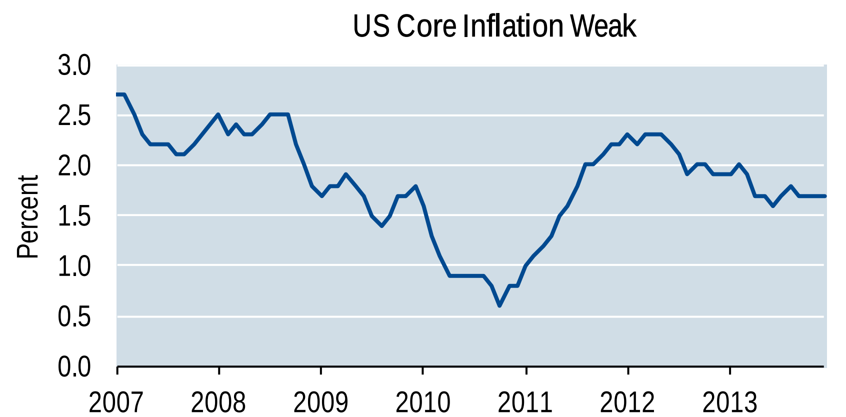
Source: Bloomberg. As of 28 Feb 14



Source: Bloomberg. As of 31 Jan 14



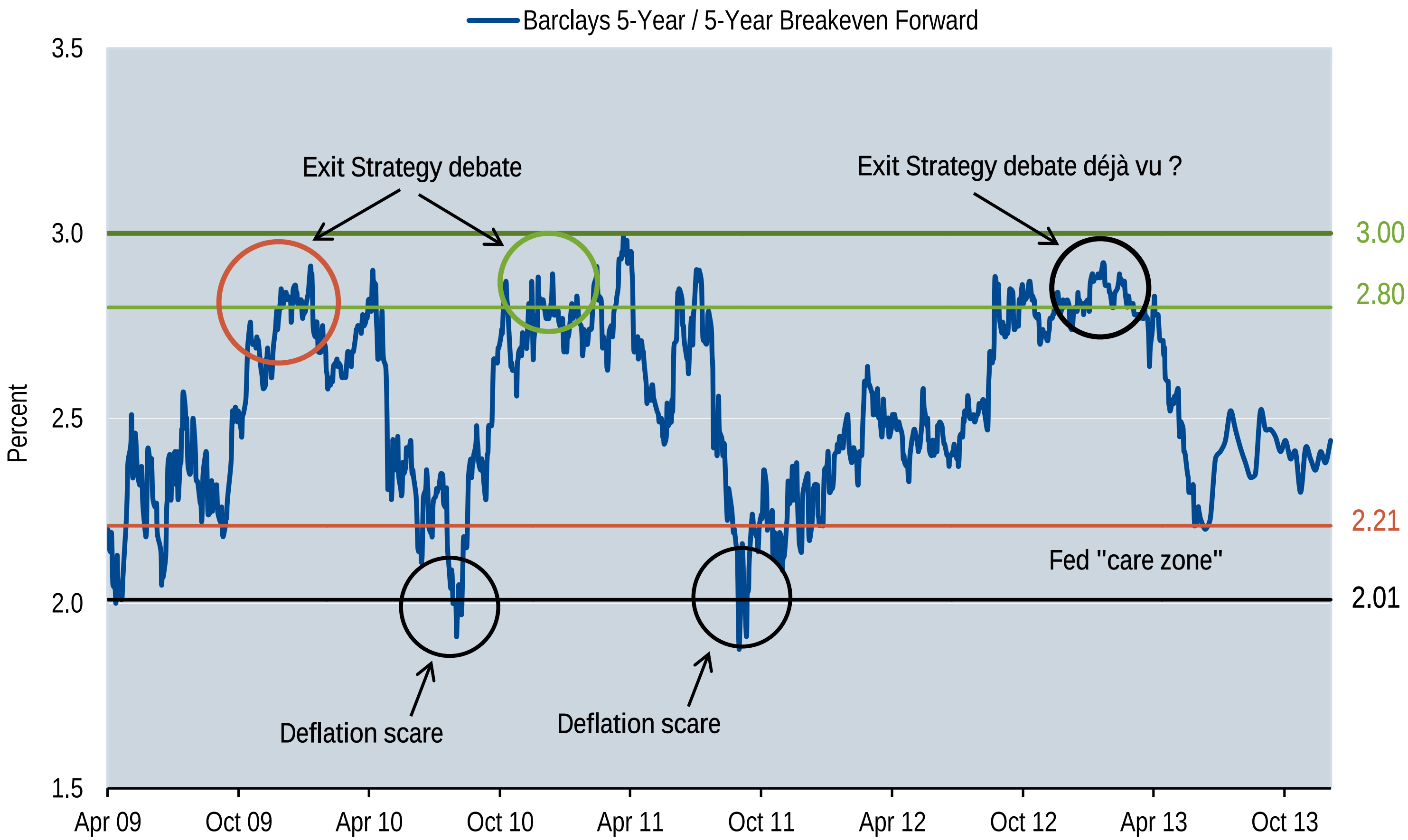
Source: Bloomberg. As of 28 Feb 14



Source: Bloomberg. As of 31 Jan 14

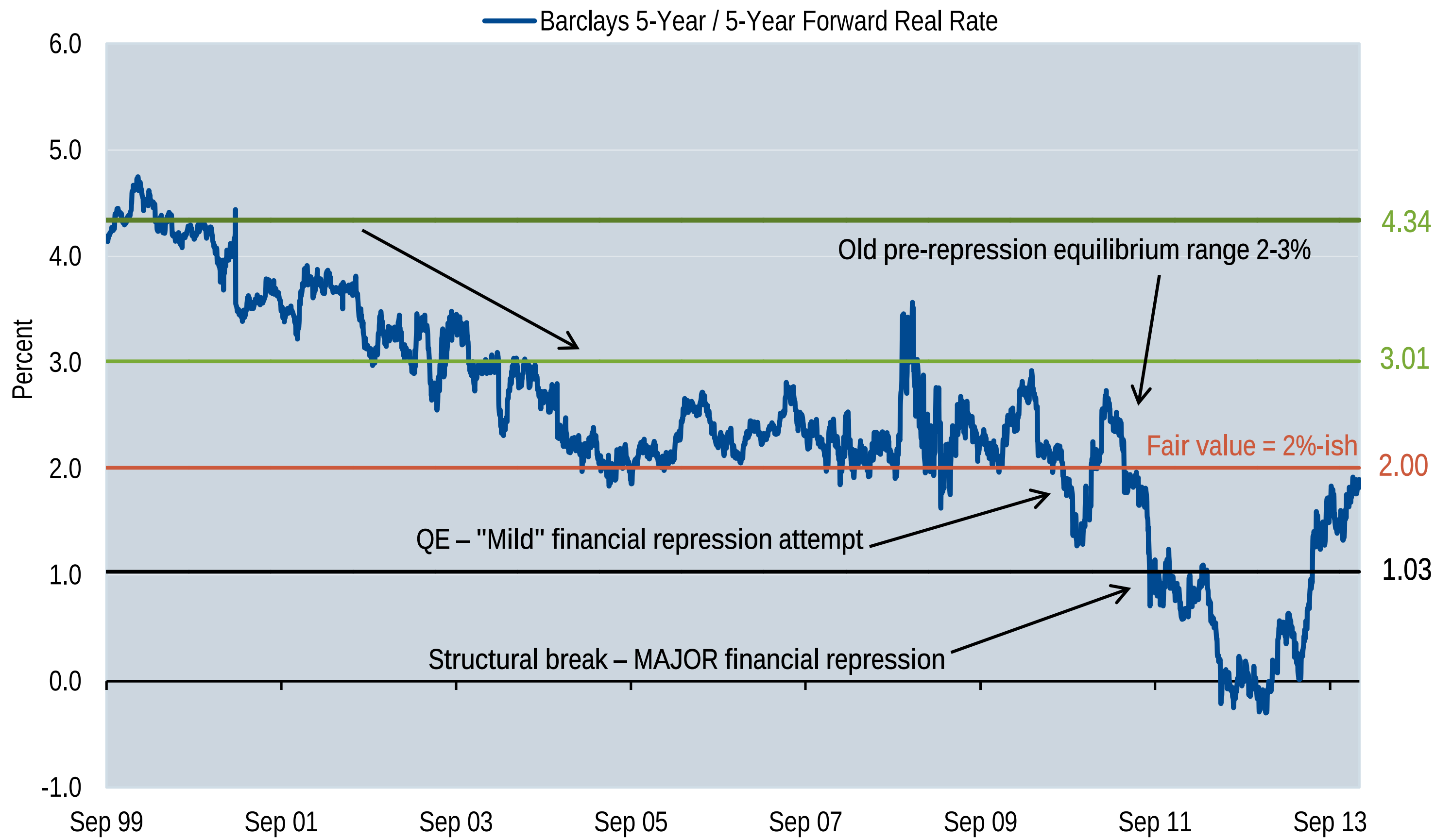
WESTERN ASSET

Inflation Outlook



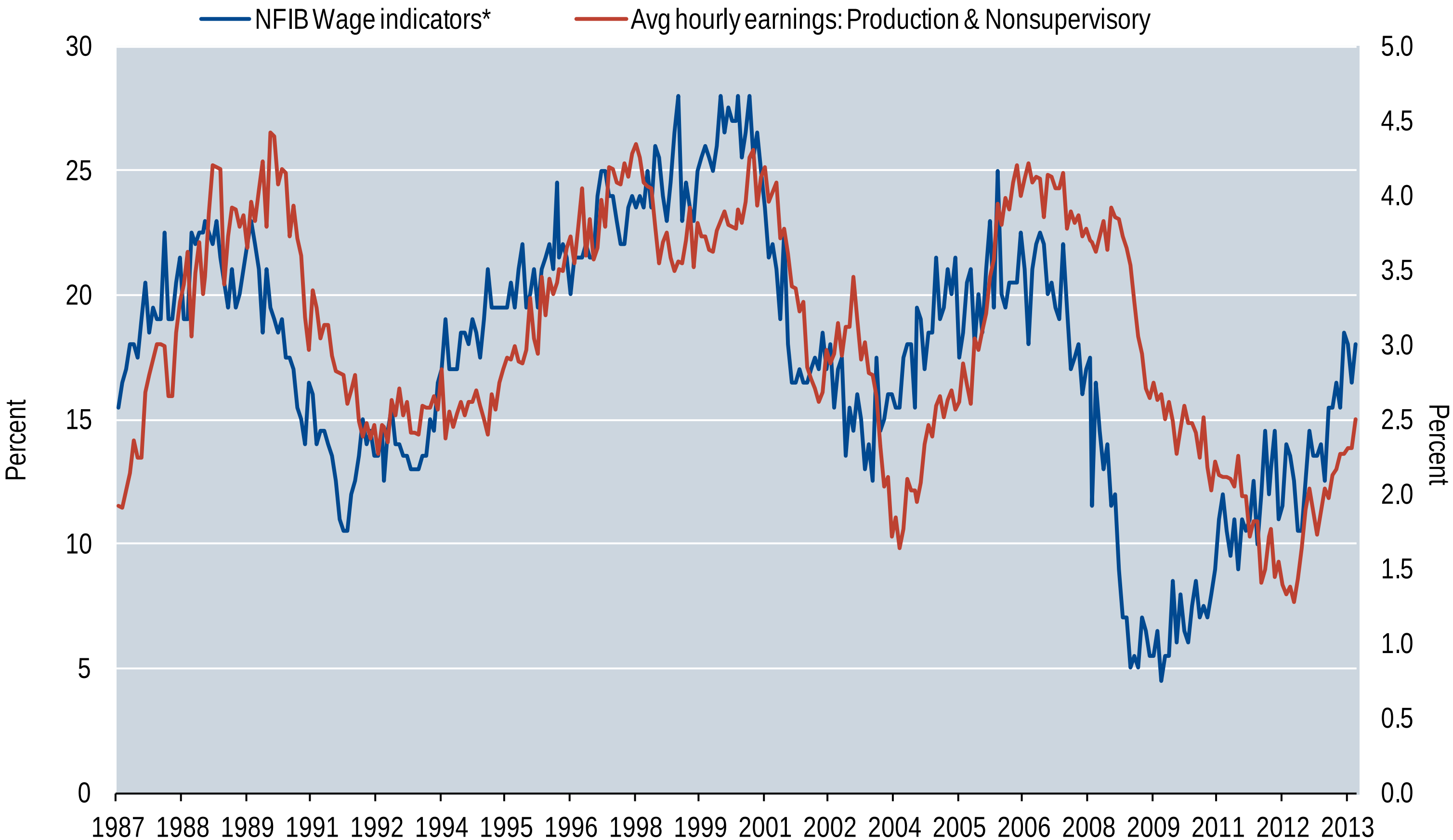
Source: Bloomberg, Barclays. As of 31 Dec 13

A Valuation Metric for Real Yields



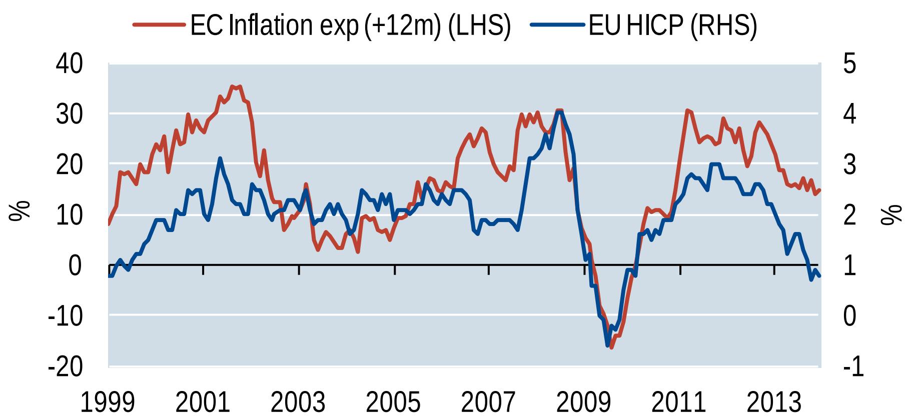
Source: Bloomberg, Barclays. As of 31 Dec 13

Wage Indicators and Earnings

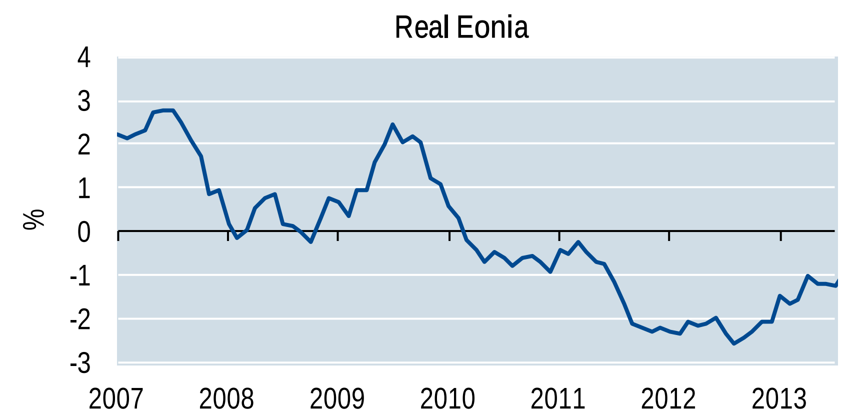


Source: NFIB. As of 28 Feb 14
**Average of those planning to raise future compensation and those with a job position which they cannot fill*

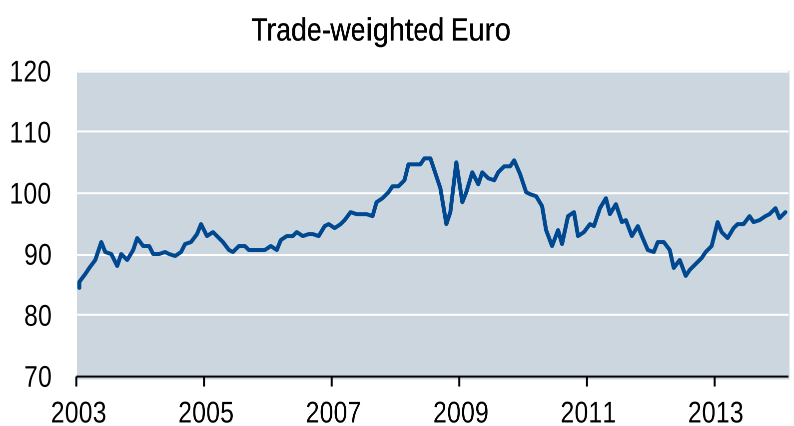
Policy Outlook - ECB



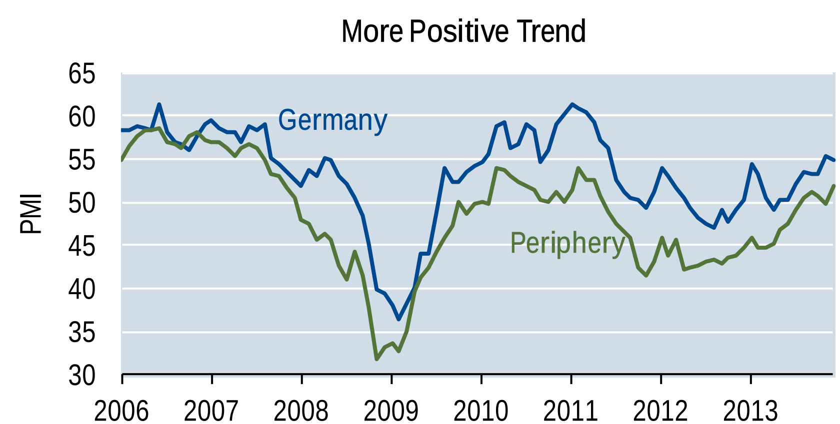
Source: Haver. As of 31 Dec 13



Source: Western Asset. As of 31 Dec 13

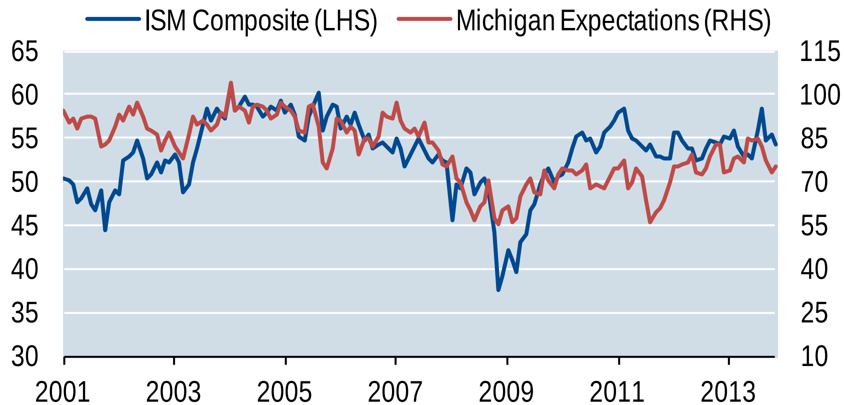


Source: Bloomberg. As of 28 Feb 14

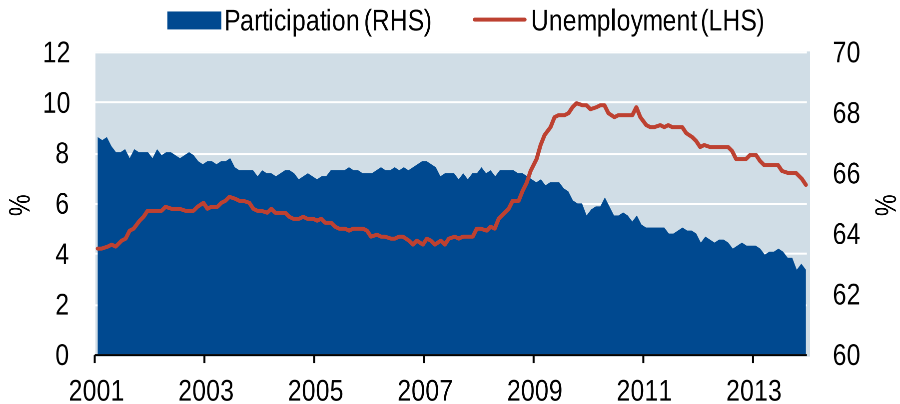


Source: Bloomberg. As of 31 Dec 13

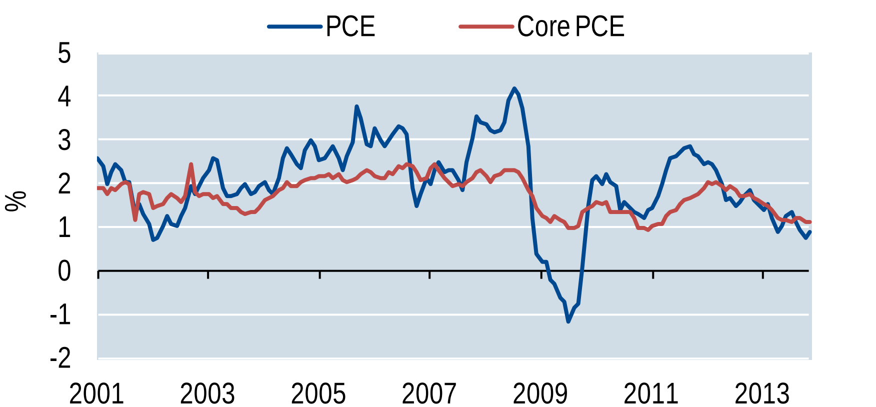
Policy Outlook - Fed



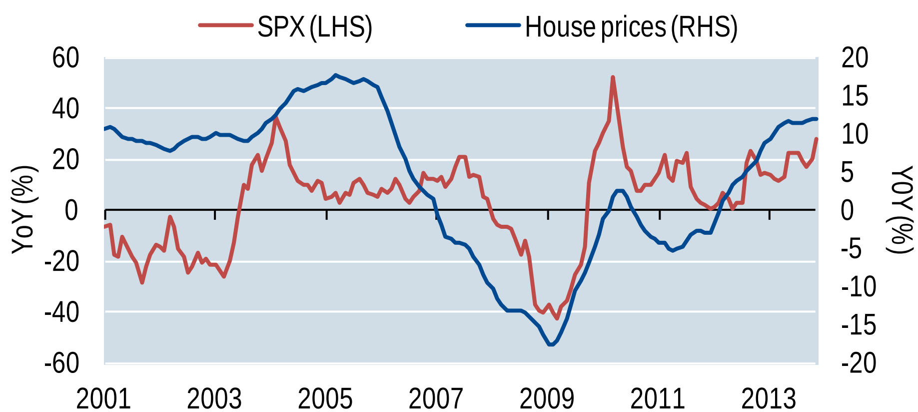
Source: Insitute of Supply Management. As of 31 Dec 13



Source: Bureau of Labour Statistics. As of 31 Dec 13

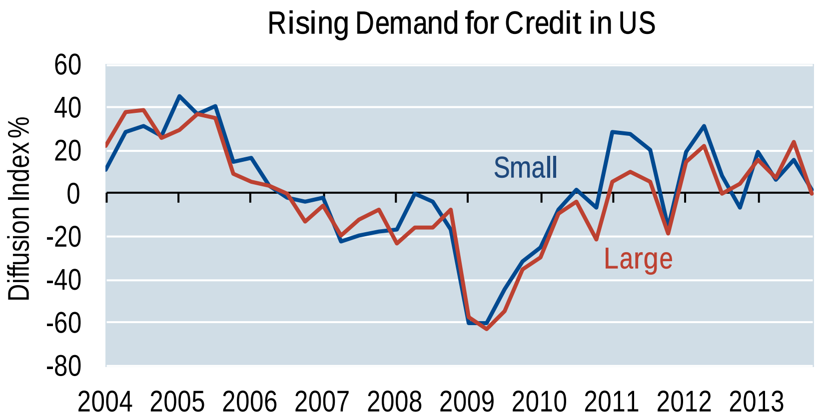


Source: Bureau of Labour Statistics : Consumer Sentiment. As of 31 Dec 13

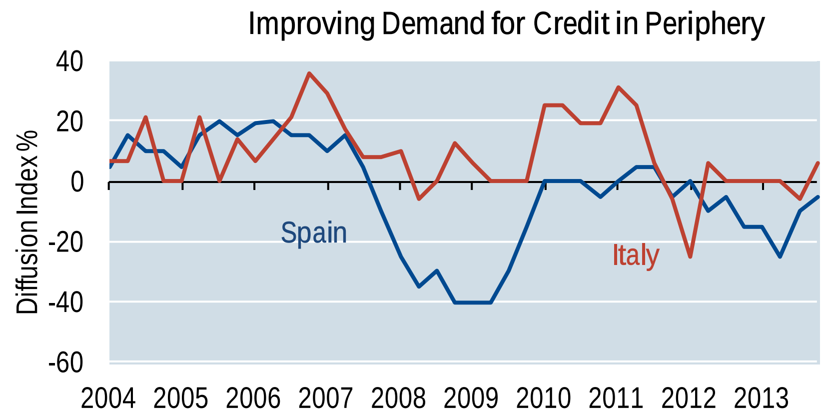


Source: University of Michigan: Consumer Sentiment. As of 31 Dec 13

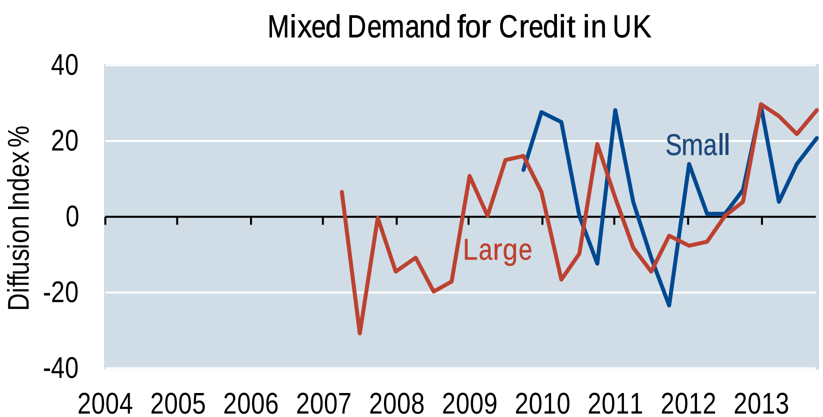
Policy – Credit Demand



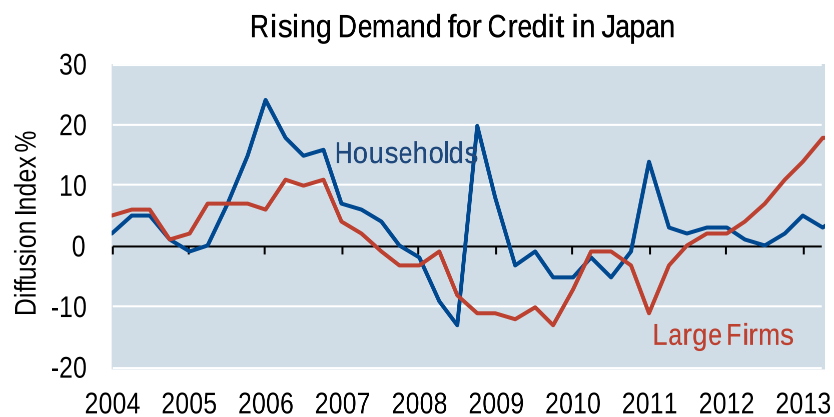
Source: Bloomberg. As of 31 Dec 13



Source: Bloomberg. As of 31 Dec 13



Source: Bloomberg. As of 31 Dec 13



Source: Bloomberg. As of 30 Sep 13

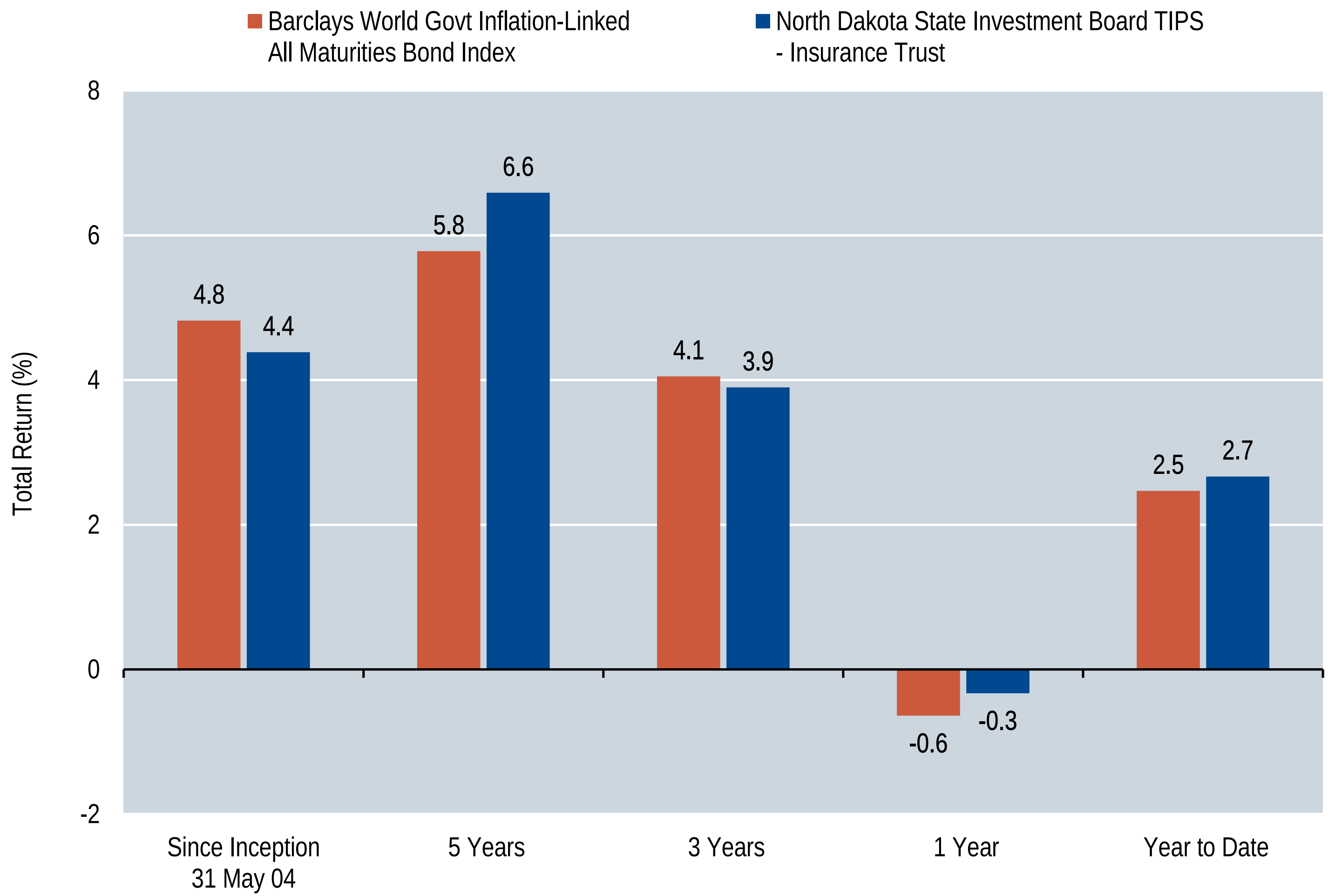
Portfolio Strategy – Inflation

Country	10yr Avg Inflation (%)	10yr High Inflation (%)	10yr Low Inflation (%)	Current Inflation (%)	Consensus Inflation 2014 (%)	Consensus Inflation 2015(%)	*Current 10yr BE (%)*
US	2.40	5.50	-2.00	1.20	1.70	2.00	*2.27*
Canada	1.80	3.70	-1.00	1.00	1.50	1.90	*1.78*
Euro	2.10	4.10	-0.80	0.80	1.20	1.50	*1.51*
France	1.70	1.00	-0.80	0.60	1.30	1.40	*1.78*
Germany	1.70	3.40	-0.40	1.30	1.60	1.90	*n/a*
Italy	2.20	4.10	0.00	0.70	1.20	1.40	*n/a*
Sweden	1.30	4.40	-1.50	0.10	1.20	1.90	*1.52*
UK RPI	3.30	5.20	1.10	2.60	2.90	3.00	*3.05*
Australia	2.80	5.00	1.20	2.20	2.60	2.50	*2.53*
Japan	-0.10	2.30	-2.50	1.60	2.40	1.70	*1.11*
China	3.10	8.70	-1.80	2.50	3.10	3.20	*n/a*

Source: Barclays, Bloomberg, Western Asset. As of 13 Jan 14

Portfolio Review

Investment Results



As of 28 Feb 14. Returns for periods greater than one year are annualized. Returns since inception are as of the indicated close of business day.
The performance calculation reflects the deduction of administrative and custodian fees only.
The impact of advisory fees on performance is not reflected in this calculation.

Performance Attribution

Western Asset Global Inflation-Linked Plus L.L.C. vs. Barclays World Inflation-Linked All Maturities Index

February 28, 2014

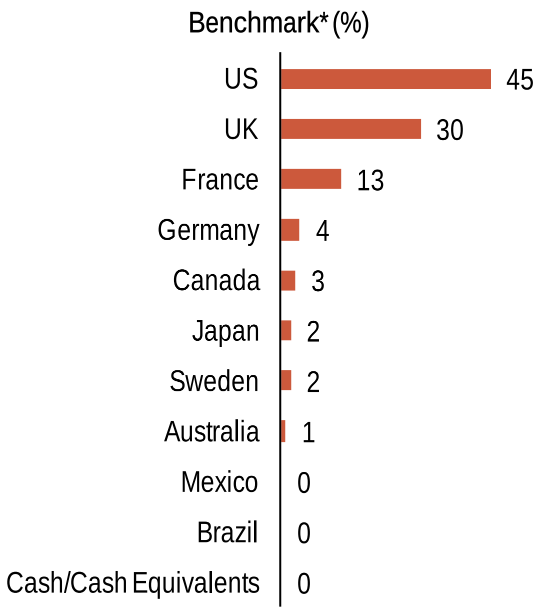
Basis Points	1 Year
Duration	19
Country	15
Yield Curve	-2
Currency	14
Sector Allocation	-4
Subsector Allocation	0
Selection/Residual	-6
Total	36

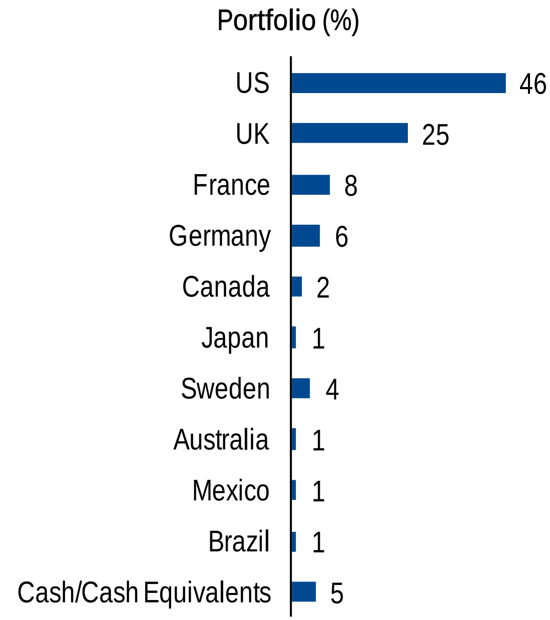
Western Asset believes that attribution is not a hard science, but rather a means of evaluating strategies to determine their relative impact on overall portfolio performance. The intent of the manager, therefore, is critical in the evaluation of different strategies, and the return attribution for any sector or strategy could be over or understated due to its inclusion in another component. Data may not sum to total due to rounding.

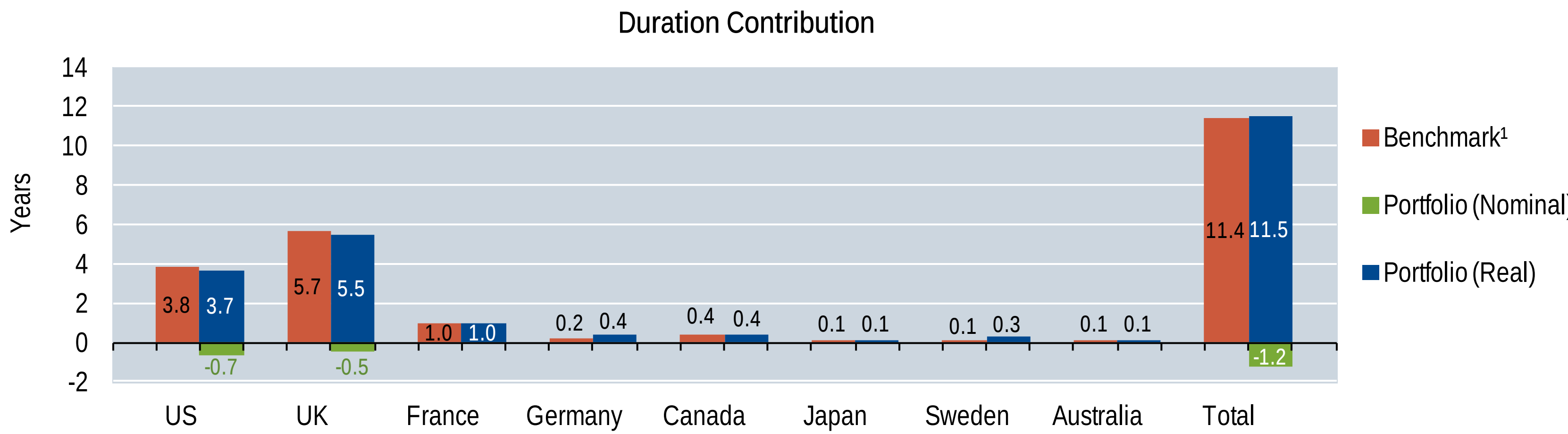
Note: 1 basis point = 0.01%

Western Asset Global Inflation-Linked Plus L.L.C.

February 28, 2014







[1]*Barclays World Inflation-Linked All Maturities Index*

Appendix

MBS/ABS Team Review

MBS/ABS Team Structure

Western Asset has a team of 15 investment professionals that are directly involved in the management of MBS/ABS portfolios. This team consists of four portfolio managers that are further supported by 11 analysts

The MBS/ABS Team is led by Mr. Anup Agarwal, who is responsible for the day-to-day strategic oversight of the portfolio's investments and for supervising the operations of the various sector specialist teams within the sector.

Anup Agarwal (16 years)
Head of MBS/ABS

Product Managers

- Travis M. Carr, CFA (20 years)
- Elliott R. Neumayer (10 years)

Agency MBS

- Benjamin Birnbaum (7 years)
- Sean O. Johnson, CFA (24 years)
- Kunle Williams (6 years)
- Bonnie M. Wongtrakool, CFA (14 years)

Structured Products

- Alba Abourjeili, CFA (11 years)
- Edwin B. Anderson (11 years)
- Greg E. Handler, CFA (13 years)
- Ben Hunsaker, CFA (9 years)
- Ian Justice (15 years)
- Liam P. Lynch (12 years)
- Jenny Park, CFA (8 years)
- Sudibyo Pradono (10 years)
- David F. Shriver (6 years)
- Harris A. Trifon (15 years)

As of 17 Mar 14
The above includes investment and non-investment professionals.

MBS/ABS Team Structure

Name	Job Title	Industry Start Date	Firm Start Date
Anup Agarwal	Head of MBS/ABS	1997	2013
Alba Abourjeli, CFA	Research Analyst	2001	2004
Edwin B. Anderson	Quantitative Analyst	2002	2011
Benjamin Birnbaum, CFA	Research Analyst	2006	2007
Greg E. Handler, CFA	Research Analyst	2001	2002
Benjamin L. Hunsaker, CFA	Portfolio Manager	2005	2008
Sean O. Johnson, CFA	Research Analyst	1989	1995
Ian Justice	Research Analyst	1997	2005
Liam P. Lynch	Portfolio Analyst	2001	2008
Jenny Park, CFA	Research Analyst	2004	2005
Sudibyo Pradono	Research Analyst	2003	2013
David F. Shriver	Portfolio Analyst	2003	2013
Harris Trifon	Portfolio Manager	2000	2014
Kunle Williams	Portfolio Analyst	2003	2011
Bonnie M. Wongtrakool, CFA	Portfolio Manager	1994	2003

The MBS/ABS Team operates under the purview of the US Broad Strategy Committee which develops the Firm's economic outlook and investment strategy for all accounts. They are further supported by a larger broad market team. Western Asset's investment management team consists of 127 investment professionals with an average industry experience of 21 years.

MBS/ABS Team Structure

Category	March 2014
Investment Professionals	127
Portfolio managers	54
Portfolio manager/research analysts	11
Research analysts	48
Traders	14

Recent Turnover

Name	Title	Joined/Left /Transferred	Date	Reason	Years with the Firm	Replacement
Harris Trifon	Portfolio Manager	Joined	2014	–	–	
Anup Agarwal	Head of MBS/ABS	Joined	2013	–	–	–
Sudibyo Pradono	Research Analyst	Joined	2013	–	–	–
Paul Jablansky	Co-Head of Structured Products	Joined	2011	–	–	–
Stephen P. Fulton	Head of Agency MBS	Left	2013	Retired	13	–
Deborah R. Slogoff	Research Analyst	Left	2013	Resigned	11	–
Paul Jablansky	Head of Structured Products	Left	2013	Resigned	2	Anup Agarwal
Ronald Mass	Co-Head of Structured Products	Left	2012	Resigned	21	–
Jeffrey T. Katz	Research Analyst	Left	2011	Resigned	13	–

Western Asset's team approach to investment management provides a thorough backup in the event that assigned personnel depart from the Firm. This team approach serves as the safety net in the Firm's investment management procedures to ensure the departure of any one professional would not impact the investment management process. Due to Western Asset's traditional team orientation to investment management, none of the changes are considered material or have adversely impacted the team.

January 31, 2014

Dear Client,

As you are likely aware, the US Securities and Exchange Commission (SEC) and US Department of Labor (DOL) announced settlements with Western Asset relating to two longstanding investigations. I am writing to provide a brief overview of these settlements and also to correct some misinformation that has been circulating about these issues. Western Asset regrets that SEC regulators believed that they needed to take the action they did, and understands that these events can place a burden on clients to evaluate the issues and in many cases explain the issues to boards and other third parties. That said, the actions are settlements of complex factual and legal issues and, as noted, Western Asset did not admit or deny the matters in the settlements. We would, however, like to challenge any characterization of the charges as involving intentional misbehavior or intent to mislead clients.

The first matter relates to the 2007 purchase for ERISA client portfolios of a corporate security, whereby the security's terms restricted purchases by ERISA clients. As a result of internal miscommunication and misunderstanding, the security's restriction was not caught and therefore was not coded into our systems. Upon discovery of the error in late 2008, we worked closely with outside counsel to research the legal consequences of this issue, analyzing both the security itself and the various provisions of ERISA. The advice we received was that the purchase did not result in any violation of ERISA or put clients at risk under that statute. Based on this advice and on a review of client guidelines, we concluded that, except for a small number of clients with specific guideline issues, clients were not at risk. We continued to hold the security in the ordinary course and ultimately sold the security in 2009 for investment reasons. The SEC began its inquiry of the matter in the fall of 2009, joined by the DOL in 2010. In 2010 we notified clients that held the security Glen Meadow. The SEC and DOL ultimately disagreed with our assessment. Rather than litigate the matter, Western Asset agreed to settle, including $10 million in amounts paid to clients and the payment of a $1,000,000 fine to each of the SEC and the DOL. Insurance will cover substantially all of the cost of client reimbursement.

The second matter relates to a trading practice in the non-agency RMBS sector. In the midst of the credit crisis, Western Asset was required to sell many non-agency RMBS due to client withdrawals and rating downgrades. Despite these forced sales, our investment team believed that many of these securities were undervalued and represented an attractive investment opportunity for client accounts where permitted. To seek to facilitate that retention, the traders would solicit bids, sell at the highest bid, and then seek a reoffer or repurchase of the security for another account. This practice does not raise regulatory issues so long as the broker is at risk and the repurchase is not guaranteed or prearranged. If the broker is not at risk, the trade may be viewed as a cross trade. In the fall of 2010, the SEC along with other agencies, began a review of Western Asset's trading practices. Upon review of our trading records, the regulators have not taken issue with the majority of these transactions. They believe, however, that the broker did not take on market risk with a small subset of the repurchases. Their conclusions rest on an analysis of trading patterns and communication between the traders and certain dealers. There are no allegations that Western Asset received any benefit from the trades, nor that Western Asset did not achieve best open market execution for either buyers or sellers. The regulators did find, however, that those transactions they believe are cross trades should have been completed for ERISA plans and SEC-registered investment companies at a mid-market price, as provided under certain technical rules governing these types of entities. The factual and legal analysis involved in this matter is complex. As with the Glen Meadow issue, in order to avoid the costs and distractions of litigation and in light of the relatively small number of trades involved, we have agreed to settle the matter. Without admitting or denying the findings, Western Asset agreed to compensation to clients of approximately $7.4 million and the payment of a $1,000,000 fine to the SEC and a $607,717 fine to the DOL. Insurance will cover substantially all of the cost of client reimbursement.

Western Asset Management Company
385 East Colorado Blvd., Pasadena, CA 91101 ▪ Tel: 626.844.9400 ▪ Fax: 626.844.9450

Again, we regret that regulators saw fit to bring these actions, and we apologize for any alarm that this news and the subsequent headlines may have caused you. We encourage you to read the SEC Orders to gain a more balanced understanding of the issues, as we believe that press reports have resulted in a distorted view of the settlements—a view that is actually at odds with the SEC filings. There are a few terms and phrases that have repeatedly come up in these articles that I would like to address.

First, the use of the term "defraud" in the SEC press release can easily be misinterpreted without the context of the full provisions included in the Investment Advisors Act. Western Asset does not believe that the SEC's headline was an entirely fair representation, as it leaves the impression of intent to mislead. In neither matter has there been any allegation from the SEC that Western Asset set out to intentionally mislead its clients.

In reference to the Glen Meadow security, there is mention that Western Asset "overrode the system" in its handling of Glen Meadow, allowing a non-ERISA security to be purchased into ERISA accounts, thereby implying that this was done intentionally. *Although an error was made, this was made as a result of human error and system design, not with the intent to conceal.*

Additionally, there were questions raised about the timing of reaching out to clients and informing them that there was a violation in their accounts. As explained above, our actions were guided by legal and factual analysis of the situation. Although the regulators ultimately disagreed with our legal analysis, there is no allegation that our view was not based in good faith. *The decision of how and/or when to inform clients was not made to avoid contacting clients, but rather because we believed these violations were not violations with respect to clients, and therefore did not require disclosure to clients.* Ultimately, when the SEC identified this as a potential issue in 2010, we contacted all affected clients. We explained the cause of the error and the research and analysis we conducted in concluding that we had not breached their guidelines or ERISA law.

Western Asset has redoubled its efforts over the past five years to address regulatory compliance and related matters to ensure that we keep pace with new regulatory demands and with our clients' expectations. Both our ERISA restriction review processes and cross-trading controls have been substantially revised and improved. This infrastructure has resulted in an increased ability to impose blocks on trades with a higher risk of being deemed to be impermissible cross trades. It has also resulted in revised workflows and processes with respect to newly issued securities and the accompanying security characteristics. As an addendum to this letter, I have included a more detailed summary of the remedial measures that have been implemented to improve our oversight processes as it relates to these matters.

We feel our reputation and integrity are being unfairly portrayed by these releases. In over 40 years of providing investment management services, Western Asset has always sought to meet high client and fiduciary standards. We have maintained a variety of policies and procedures designed to ensure that we carry out our fiduciary duty to the best of our abilities and put the interests of our clients first. Our corporate culture places the highest priority on compliance that permeates every department and every employee at our Firm, and we constantly seek ways to enhance our robust compliance program.

We hope this letter has offered you some insight and comfort on the news of the recent settlements. We are pleased to have settled, and we are looking forward to putting these long outstanding issues behind us. If you have any questions or if you would like to discuss any of these matters further, please do not hesitate to contact me or your Client Service Executive—we are here to help.

Thank you for your business and continued support.

Sincerely,

James J. Flick
Director of Global Client Service and Marketing

WESTERN ASSET

Corrective Measures and Enhancements Made by Western Asset

Western Asset Management Company
January 2014

Western Asset has implemented a variety of enhancements to policies, procedures and processes over the past several years that are designed to address the concerns raised by the various regulatory agencies during recent inquiries. Those inquiries have focused around two concerns. First, effective controls are needed to ensure that security repurchases do not constitute cross trades that don't comply with the technical requirements for US 1940 Act mutual funds and ERISA clients. Second, effective controls are needed to ensure that requirements precluding purchase by ERISA investors and imposed by issuers of fixed-income instruments are followed.

Cross Trade Controls

With respect to the security repurchase topic, Western Asset implemented the following types of changes:

- Enhanced compliance policies to prohibit same day or next-day repurchases without Legal and Compliance Department approval. In essence, even perfectly legal reoffer trades cannot be done without a minimum two day period before asking for a reoffer from the broker.
- Implemented additional post-trade monitoring to identify trades of potential concern through development of automated monitoring tools to capture potential cross trades and reoffers.
- Provided additional staff training on the topic.
- Added automated controls within the trading system to block the posting of purchase trades for most asset classes when there is a prior sale of the same CUSIP to the same broker (certain highly liquid asset classes such as US Treasuries are exempt from the block).
- Engaged an external independent compliance consultant in 2011 to review Western Asset's controls. Some enhancements were made prior to the consultant's review, but Western Asset has implemented controls that met or exceeded the recommendations.

ERISA restrictions

With respect to the risk of purchasing instruments with ERISA restrictions for ERISA investors, Western Asset implemented the following types of enhancements:

- Developed new workflow for making ERISA eligibility determinations on new instruments between the investment management, security master file, and legal and compliance functions. Responsibility for review of ERISA restrictions is now in the Legal and Compliance Department.
- As part of this new workflow, instruments in asset classes with a higher risk of ERISA restrictions such as non-agency structured product or emerging market are deemed ERISA ineligible, and are accordingly blocked for ERISA account approval unless Legal and Compliance Department concludes that there is sufficient information to make a determination to permit the trade. Instruments in asset classes such as corporate bonds with lower risk of such restrictions may be permitted, but must be verified within 10 days from trade date.
- Enhanced the process for obtaining relevant prospectus documentation from brokers.
- Conducted training of relevant staff.

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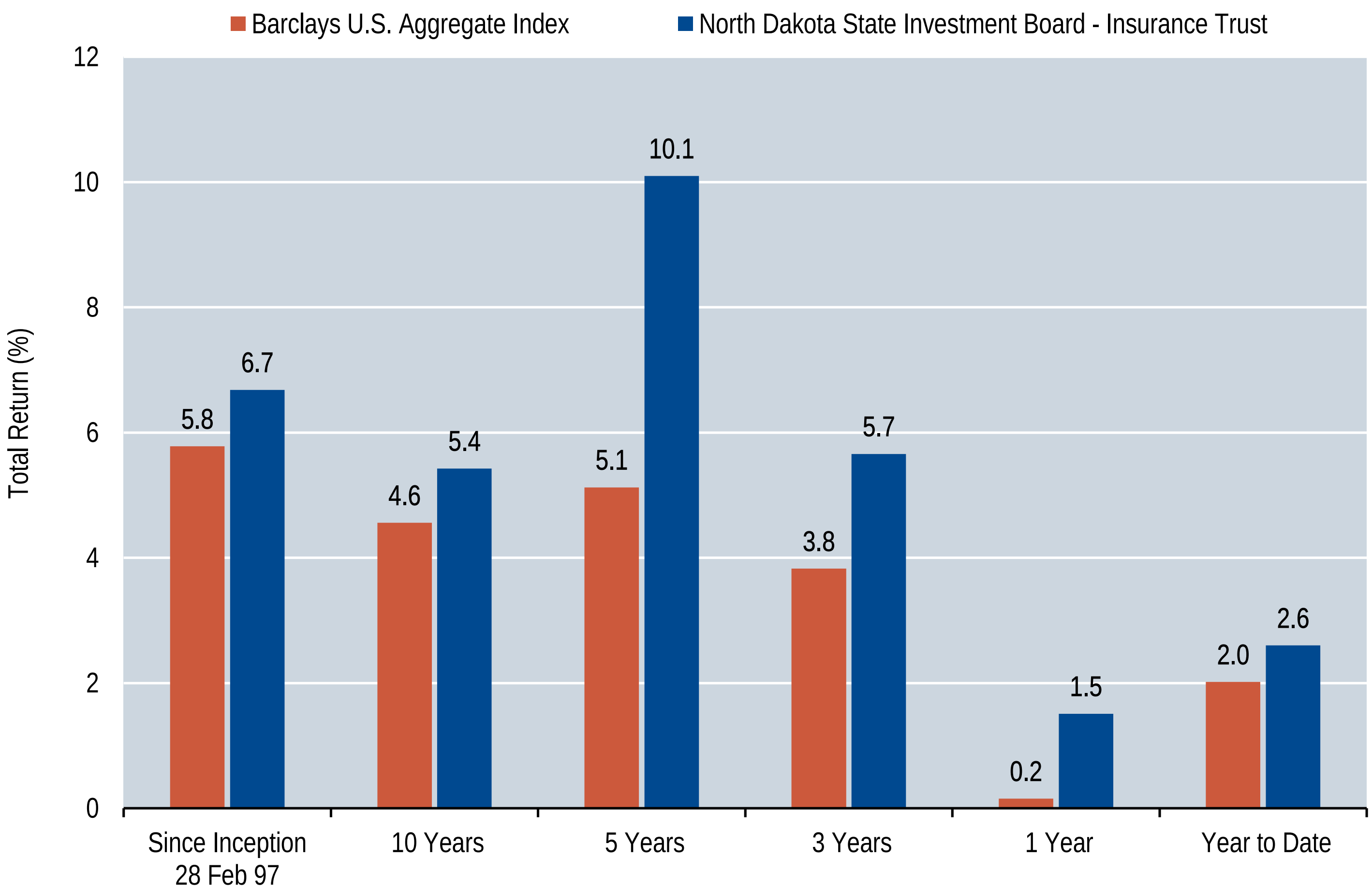
General

Over the past five years or so, Western Asset has invested significantly in additional compliance resources and procedures that will benefit both areas of regulatory agencies' concerns. There has been an ongoing development of additional compliance infrastructure to support the portfolio guideline compliance process. Western Asset developed additional controls to permit the trading systems to communicate directly with the portfolio compliance systems. This was a multi-year effort and involved new automated tools and interfaces, clean-up and re-evaluating rule coding, and overhauling the process for determining characteristics for individual securities. In late 2010, Western Asset launched functionality that permitted individual rules to be checked in an automated manner in the trading system, return immediate results to traders and provide for blocks in the trading system. Western Asset now checks the vast majority of trades prior to booking the transaction into client portfolios on trade date. Many of the checks are automated in nature. This provides quicker response time to traders and permits pre-trade compliance officers to focus on the higher-risk guidelines in client accounts such as rules that cannot be coded in an automated manner. Western Asset continues to seek opportunities to make the process more effective and efficient, such as looking for opportunities to automate rules that currently require manual checking.

This infrastructure has resulted in an improved ability to impose blocks on trades with a higher risk of being deemed to be an impermissible cross trade. It has also resulted in revised workflows and processes with respect to new issues and the accompanying security characteristics. The infrastructure changes were not made in response to regulatory inquiries or at the request of any regulator, but they have provided additional capability to develop and implement additional controls.

In addition to these enhancements, Western Asset has also developed additional post-trade monitoring which provides additional focus on a variety of regulatory risk areas. A variety of automated exception based tools are utilized to isolate particular trades of interest in the trade blotter. Topics of interest include potential cross-trades, trade allocation for accounts in shared composites, trade allocation for high-risk accounts (such as alternative investment, performance fee and proprietary accounts), insider trading, and "window dressing" for US mutual funds.

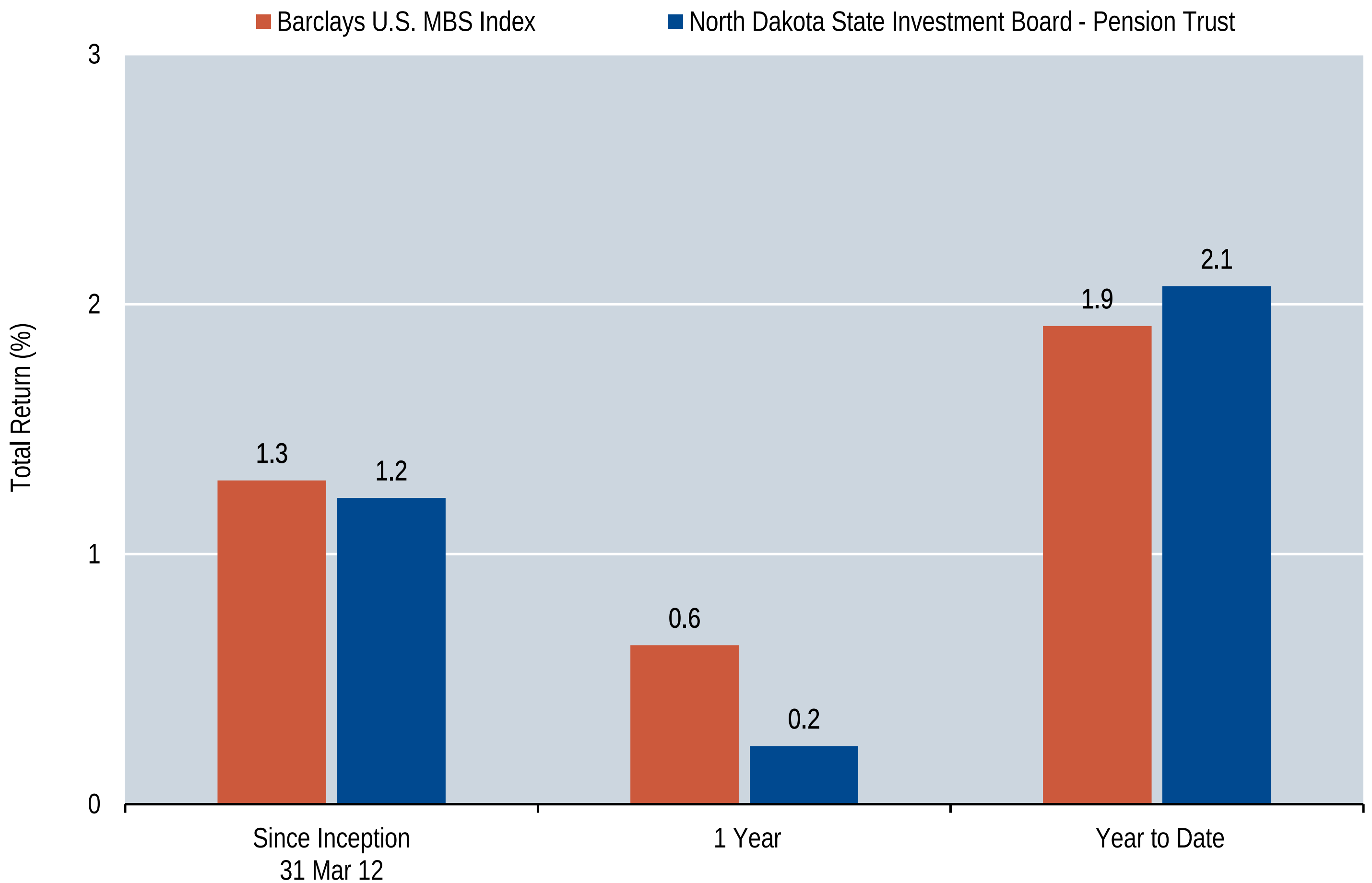
Investment Results



As of 28 Feb 14. Performance shown is gross of fees. The account's actual return will be reduced by those fees and any other expenses chargeable to the account. The fee schedule for this strategy may be found in Part 2 of Western Asset's Form ADV. As fees are deducted quarterly, the compounding effect will be to increase the impact of the fees by an amount directly related to the gross account performance. For example, on an account with a 1% annual fee, if the gross performance were 10%, the compounding effect of the fees would result in a net performance of approximately 8.93%. Returns for periods greater than one year are annualized. Returns since inception are as of the indicated close of business day.

WESTERN ASSET

Investment Results



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Representative Client List Disclosure

The clients listed in the Corporate company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $46(M) or greater.
The clients listed in the Public company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $83(M) or greater.
The clients listed in the Multi-Employer / Union company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $7(M) or greater.
The clients listed in the Eleemosynary company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $1(M) or greater.
The clients listed in the Insurance company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $36(M) or greater.
The clients listed in the Healthcare company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $19(M) or greater.
The clients listed in the Sub-Advisory company type are in all mandates, located in all countries and all regions of the United States, and with portfolios with an AUM of $12(M) or greater.

Clients that have advised Western Asset of account terminations have been excluded from the lists.

As of 31 Jan 14

Risk Disclosure

Past results are no guarantee of future performance. An investment in the Portfolio may be worth more or less than you originally paid for based on factors such as interest rate, credit, strategy and limited liquidity risks. Additional risks and information regarding fees, expenses and tax considerations are more fully described in the Confidential Offering Memorandum, which must precede or accompany this material. Please read the Offering Memorandum carefully before investing.

Request for Information response submitted to:

North Dakota State Investment Board

March 20, 2014

WESTERN ASSET

Disclaimer

Western Asset Management is a global asset management firm, comprised of seven legal entities that operate together as one. The entities include: Western Asset Management Company (the Pasadena and New York offices); Western Asset Management Company Limitada (the Sao Paulo office); Western Asset Management Company Limited (the London office and the Dubai branch office); Western Asset Management Company Pte. Ltd. (the Singapore office); Western Asset Management Hong Kong (the Hong Kong office); Western Asset Management Company Ltd (the Tokyo office); and Western Asset Management Company Pty Ltd (the Melbourne office). Note that the Hong Kong office (fixed-income business), although a division of Legg Mason Asset Management Hong Kong Limited, is operated and managed by Western Asset, and is therefore hereafter referred to as the Hong Kong office.

The entity responding to this request is Western Asset Management Company (the Pasadena and New York offices). The following response, while it covers all seven of these organizations, reflects the Firm's general business approach. Specific details may vary from office to office depending on local circumstances, and may change as Western Asset continues to evolve. Unless specifically noted, references to "Western Asset" and "Firm" represent all seven entities.

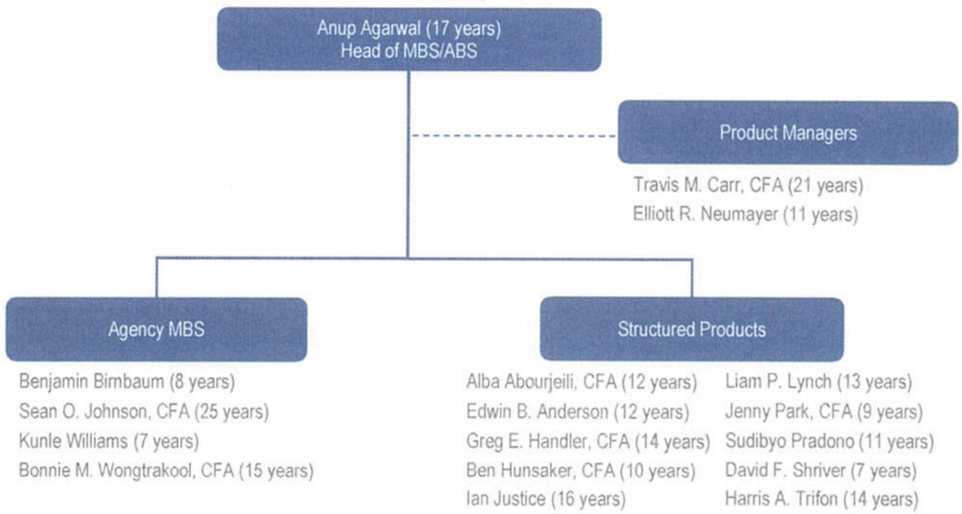
Except as specifically noted, all data is as of March 20, 2014, and all currency is represented in US dollars.

MBS/ABS Team Structure

Western Asset has a team of 15 investment professionals that are directly involved in the management of MBS/ABS portfolios. This team consists of four portfolio managers that are further supported by 11 analysts

The MBS/ABS Team is led by Mr. Anup Agarwal, who is responsible for the day-to-day strategic oversight of the portfolio's investments and for supervising the operations of the various sector specialist teams within the sector.

MBS/ABS Team



As of 17 Mar 14
The above includes investment and non-investment professionals.

Name	Job Title	Industry Start Date	Firm Start Date
Anup Agarwal	Head of MBS/ABS	1997	2013
Alba Abourjeli, CFA	Research Analyst	2001	2004
Edwin B. Anderson	Quantitative Analyst	2002	2011
Benjamin Birnbaum, CFA	Research Analyst	2006	2007
Greg E. Handler, CFA	Research Analyst	2001	2002
Benjamin L. Hunsaker, CFA	Portfolio Manager	2005	2008
Sean O. Johnson, CFA	Research Analyst	1989	1995
Ian Justice	Research Analyst	1997	2005
Liam P. Lynch	Portfolio Analyst	2001	2008
Jenny Park, CFA	Research Analyst	2004	2005
Sudibyo Pradono	Research Analyst	2003	2013
David F. Shriver	Portfolio Analyst	2003	2013
Harris Trifon	Portfolio Manager	2000	2014
Kunle Williams	Portfolio Analyst	2003	2011
Bonnie M. Wongtrakool, CFA	Portfolio Manager	1994	2003

The MBS/ABS Team operates under the purview of the US Broad Strategy Committee which develops the Firm's economic outlook and investment strategy for all accounts. They are further supported by a larger broad market team. Western Asset's investment management team consists of 127 investment professionals with an average industry experience of 21 years.

Category	March 2014
Investment Professionals	**127**
Portfolio managers	54
Portfolio manager/research analysts	11
Research analysts	48
Traders	14

Recent Turnover

Name	Title	Joined/Left /Transferred	Date	Reason	Years with the Firm	Replacement
Harris Trifon	Portfolio Manager	Joined	2014	–	–	
Anup Agarwal	Head of MBS/ABS	Joined	2013	–	–	–
Sudibyo Pradono	Research Analyst	Joined	2013	–	–	–
Paul Jablansky	Co-Head of Structured Products	Joined	2011	–	–	–
Stephen P. Fulton	Head of Agency MBS	Left	2013	Retired	13	–
Deborah R. Slogoff	Research Analyst	Left	2013	Resigned	11	–
Paul Jablansky	Head of Structured Products	Left	2013	Resigned	2	Anup Agarwal
Ronald Mass	Co-Head of Structured Products	Left	2012	Resigned	21	–
Jeffrey T. Katz	Research Analyst	Left	2011	Resigned	13	–

Western Asset's team approach to investment management provides a thorough backup in the event that assigned personnel depart from the Firm. This team approach serves as the safety net in the Firm's investment management procedures to ensure the departure of any one professional would not impact the investment management process. Due to Western Asset's traditional team orientation to investment management, none of the changes are considered material or have adversely impacted the team.

Disclosure

Past results are not indicative of future investment results. This publication is for informational purposes only and reflects the current opinions of Western Asset Management. Information contained herein is believed to be accurate, but cannot be guaranteed. Opinions represented are not intended as an offer or solicitation with respect to the purchase or sale of any security and are subject to change without notice. Statements in this material should not be considered investment advice. Employees and/or clients of Western Asset Management may have a position in the securities mentioned. This publication has been prepared without taking into account your objectives, financial situation or needs. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation or needs. It is your responsibility to be aware of and observe the applicable laws and regulations of your country of residence.

James "Jim" W. Hirschmann, III

President and Chief Executive Officer
Western Asset Management Company

Mr. Hirschmann currently serves as the chief executive officer of Western Asset, Legg Mason's largest subsidiary by assets under management, and one of the world's largest fixed-income managers.

Mr. Hirschmann joined Western Asset in April 1989 in a business development capacity. In 1995, he spearheaded Western Asset's international efforts through the acquisition of Lehman Brothers Global Asset Management in London. In 1997, he relocated to London to build Western Asset's international business and integrate the US and UK operations. Soon after returning to Western Asset's headquarters in Pasadena, California, Mr. Hirschmann was appointed president and chief executive officer in 1999, and has been a key driver in the impressive growth and major global position that Western Asset has achieved as one of the world's leading bond managers.

Prior to joining Western Asset Management, Mr. Hirschmann served as Director for Financial Trust Company (currently Invesco National Trust Company) in Denver, Colorado. Before that, Mr. Hirschmann was a vice president at Atalanta/Sosnoff Capital Corporation in New York, NY.

Mr. Hirschmann holds a Bachelor of Science in Business Administration with an emphasis in Accounting from Widener University in Chester, Pennsylvania. He is a member of the Board of Trustees and also serves as a member of the Finance and Administration Committee and of the Audit Committee at Widener University.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3763 / January 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15689

In the Matter of **WESTERN ASSET MANAGEMENT COMPANY,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Western Asset Management Company ("Respondent" or "WAM").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

---

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

These proceedings arise out of an investment adviser's failure to disclose its violation of an issuer-imposed restriction prohibiting plans subject to Part 4 of Subtitle B of Title 1 of the Employee Retirement Income Security Act ("ERISA plans") from participating in a private placement. Respondent was aware no later than October 2008 that it had breached this offering restriction by allocating the security to ERISA accounts that it managed, yet failed to take prompt corrective action, contrary to its disclosed error correction policy. Specifically, Respondent did not notify most of its affected ERISA clients until August 2010, more than a year after Respondent had liquidated the securities out of all client accounts.

Respondent

1. Respondent Western Asset Management Company ("WAM"), a California corporation located in Pasadena, California, is an investment adviser registered with the Commission pursuant to Section 203(e) of the Advisers Act. WAM is a wholly-owned subsidiary of Legg Mason, Inc. As of September 30, 2013, WAM reported $442.7 billion in assets under management. WAM provides investment management services primarily to institutional clients such as pension plans and mutual funds. Many of WAM's clients are ERISA plans.

Background

2. WAM's compliance policies, including its error correction policy, were set forth in WAM's Form ADV and its compliance manual. A copy of the current Form ADV was sent to each client when its account was opened.

3. During the relevant period, WAM's policies and procedures required it to notify its clients of any breach or error resulting in a loss. Specifically, WAM disclosed the following Error Correction Policy in its Form ADV from 2007 through 2009:

> Western Asset's general policy, except where contractual arrangement or regulatory requirements provide otherwise, is (i) to make a client account whole for any net loss associated with a breach or an error (ii) to retain in a client's account, a net gain resulting from an error.
>
> ...
>
> Western categorizes breaches and errors as follows:
>
> 1. Breaches of investment guidelines and/or investment restrictions resulting from any transaction or other factor whereby a transaction and/or portfolio is not consistent with:
>   a. Regulatory requirements/restrictions (examples include, but are not limited to, legally improper or prohibited transactions with affiliates; legally improper or prohibited cash/currency transactions).
>   b. Client mandates (includes prospectus for a fund).
> 2. Operational Errors

a. Trading errors include, but are not limited to, execution of incorrect security transaction (other than as described above for breaches of guidelines, restrictions or regulations)

b. Settlement errors.

...

If breach or error occurs in a client portfolio, it is Western Asset's policy that the error will be corrected immediately or, in the case of guideline breaches, the client will be immediately be [sic] contacted to obtain a waiver. If a waiver is declined, the error will be promptly corrected. If the breach, after correction, results in a gain to the client, that gain is retained in the client portfolio. If the client suffers a loss as a result of the breach, Western Asset will reimburse the account.

4. WAM relied heavily on an automated compliance system from Charles River Development ("Charles River") to comply with client investment guidelines. Once the investment guidelines for a particular client were entered into Charles River, WAM could monitor pre- and post-trade compliance with client investment guidelines through the system.

5. As the portfolio managers selected a security for the clients, and before a trade was allocated to accounts, the compliance staff determined whether that security comported with client investment guidelines by running the proposed account allocations through Charles River. If a client had a restriction prohibiting the proposed trade, the system generated an alert and WAM's pre-trade compliance staff advised the trading desk that the trade had been rejected. In addition, each morning, compliance officers reviewed exception reports for their assigned accounts to identify any guideline issues triggered by the prior day's trading activity.

6. If the proposed investment was a new issue, WAM's compliance staff populated certain attributes of the security (features such as coupon rate, maturity, call date, registration status and ERISA eligibility) before the proposed trades were processed through Charles River for pre-trade review. WAM's compliance personnel used information obtained from outside providers like Bloomberg and its own trading desk to populate the data fields for a new security into Charles River. Compliance staff did not independently review any offering documents.

WAM's Coding Error

7. On January 31, 2007, WAM purchased $50 million of the initial offering of Glen Meadow, a $500 million private placement that was designed to provide subordinated debt financing to the Hartford Insurance Group ("Hartford"). Glen Meadow was designated by market data providers as a corporate security. WAM received the preliminary offering memorandum which stated on the first page that the securities may be offered or sold only to an "eligible purchaser," defined to exclude employee benefit plans subject to ERISA. The preliminary offering memorandum also required any participant in the offering to warrant that it was an eligible purchaser and agree to transfer the security only to other eligible purchasers, noting: "Any purported purchase or transfer of the Pass-Through Trust Securities in violation of this requirement will be void and without legal effect whatsoever. The purchaser understands and acknowledges that the Pass-Through Trust may also require the sale of its Pass-Through Trust

Securities held by persons that fail to provide such certifications or otherwise comply with the [eligible purchaser requirement]."

8. Glen Meadow was initially coded in WAM's automated compliance system as an asset-backed security that was non-ERISA eligible. On February 1, 2007, a portfolio compliance officer, following up on an exception report from an overnight compliance run, directed WAM's back office staff to change the security type from "asset-backed security" to "corporate debt." Charles River, however, had been configured so that slightly different fields appeared on screen depending on whether the security was designated asset-backed or corporate debt. Changing the designation of Glen Meadow from asset-backed to corporate debt resulted in Charles River automatically populating this field as ERISA eligible without any user input.

9. Although the trader on WAM's corporate desk who was responsible for Glen Meadow was copied on the email message directing WAM's back office staff to change the security designation thereby updating ERISA field, he did not raise any concerns about ERISA. Portfolio compliance staff told WAM's back office staff to ignore alerts triggered by the Glen Meadow security, assuring them that according to the trader on WAM's corporate desk, this was "a corporate note and is ERISA eligible." Neither the portfolio compliance staff nor the trader recognized, and accordingly neither advised the back office, that the security was not eligible for ERISA accounts.

10. In the following months, WAM continued purchasing the Glen Meadow security for the accounts of its clients, ultimately purchasing $204 million of Glen Meadow for 233 client accounts, including more than $90 million par value for 99 ERISA client accounts.

WAM's Discovery and Failure to Disclose the Coding Error

11. On October 7, 2008, WAM received an email message from a former institutional client (the "Former Client") notifying WAM that the Glen Meadow security WAM had purchased for the Former Client's master pension trust account was not ERISA eligible. By the time WAM received this notice, eight of the original 99 ERISA accounts that had purchased the Glen Meadow security were closed, transferred, or had exited the position.

12. Initially, upon learning of the coding error, WAM compliance staff changed the ERISA field in Charles River from ERISA eligible to ERISA ineligible. Re-coding the security in Charles River allowed compliance staff to run "fallout" reports to determine the impact of the error. The first fallout report completed on October 8, 2008 indicated that 94 accounts were impacted and many of these accounts were coded "[n]o non-ERISA [securities]."

13. Even though WAM had promptly identified the affected accounts, it did not immediately correct the error or notify clients. WAM's compliance staff instead completed an internal portfolio breach compliance report to document the issue reported by the Former Client. According to this report, the issue arose because "[t]he security was improperly coded as ERISA eligible when it was in fact a non-ERISA eligible security." The report also indicated that the price at purchase was "100," or par. The report further noted that when the Former Client transferred its account to a new adviser on October 1, 2008, Glen Meadow was trading at a price of $73.78, resulting in an unrealized loss of $226,872.95.

14. WAM then launched a three-month investigation into the matter. Although WAM acknowledged that an internal coding issue had caused it to breach an issuer-imposed offering restriction, WAM's compliance staff first determined that there was no "error" within the meaning of WAM's error correction policy, which specifically referenced regulatory, trading and settlement errors. WAM focused its investigation on whether there had been a violation of ERISA and whether any client guidelines had been breached. WAM staff conducted key word searches of client guidelines to determine whether any of the affected ERISA clients had guidelines forbidding investment in ERISA ineligible securities. The key word searches failed to uncover the applicable guidelines for two accounts belonging to one client. WAM compliance staff also failed to discover a guideline breach unrelated to ERISA in the account of a second client. As a result, they incorrectly concluded that the allocation of the Glen Meadow security to ERISA accounts did not violate the investment guidelines applicable to these three accounts. WAM also confirmed that the issuer-imposed restriction against participation in the offering by ERISA plans was still in place. In addition, WAM consulted with outside counsel on legal aspects of the issue.

15. In December 2008, WAM's committee which oversaw the resolution of possible investment compliance issues met and received a summary of the Glen Meadow matter from inside counsel. The committee concluded, based on the factual investigation and legal analysis of inside and outside counsel presented at that meeting, that there had been no guideline breaches and no "prohibited transaction" under ERISA, 29 U.S.C. 1106 (generally forbidding transactions between an ERISA plan, on the one hand, and a plan fiduciary or a party in interest, on the other), at the time of purchase, but that WAM might have potential exposure to the issuer for breaching the terms of the offering. In light of this information, the Committee did not discuss whether WAM had any obligations to notify clients of the allocation error under its Error Correction Policy.

16. Although WAM concluded there had been no guideline breaches or ERISA prohibited transaction affecting its clients, it realized that its ERISA clients might still be concerned. As a result, WAM explored selling the Glen Meadow position out of all ERISA accounts in February and March 2009. This effort met with little success. In an email dated March 6, 2009, a WAM trader advised his colleagues that although "we're still trying to find bids, the entire space is taking a hit and the liquidity for [Glen Meadow] is not particular [sic] well." During this time, the price of the Glen Meadow security continued to deteriorate. By March 10, 2009, real-time broker quotes for the Glen Meadow security had fallen to $22. These liquidity and pricing problems caused WAM to abandon its attempts to sell the security out of all ERISA accounts.

17. Because WAM concluded that no breach or error occurred, WAM did not notify its affected ERISA clients that it had allocated the Glen Meadow security to their accounts in violation of an issuer-imposed offering restriction. Nor did WAM offer to make its affected ERISA clients whole for losses attributable to the Glen Meadow security. By interpreting its error correction policy narrowly, WAM effectively exempted issues relating to the allocation of Glen Meadow to ERISA accounts from its own compliance controls.

18. In May 2009, Hartford announced it had received preliminary approval for Troubled Asset Relief Program funds, and liquidity and pricing for Glen Meadow improved.

Accordingly, WAM sold all holdings in the Glen Meadow security from ERISA and non-ERISA client accounts between May and June 2009 pursuant to a decision of the investment desk. Although WAM was able to sell Glen Meadow, the sales were at prices materially lower than the purchase prices for Glen Meadow for all of WAM's ERISA and non-ERISA clients.

19. Before executing these sales, WAM did not inform its ERISA clients that the Glen Meadow security had been allocated to their accounts due to its coding error. Nor did WAM advise its clients of its error immediately after selling the Glen Meadow security out of their accounts.

20. WAM did not notify its ERISA clients that it had erroneously purchased the Glen Meadow security for their accounts until August 2010, by which time WAM was aware of the SEC investigation.

WAM's Violations of Section 206(2) of the Advisers Act

21. As a result of the conduct described above, WAM willfully[2] violated Section 206(2) of the Advisers Act. This section prohibits any investment adviser from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. Pursuant to Section 206(2), investment advisers have a fiduciary duty that requires them to act in the best interests of their clients and to make full and fair disclosure of all material facts.

22. Although WAM's senior management was aware of the misallocation of Glen Meadow to ERISA accounts no later than December 2008, WAM did not promptly disclose it to affected ERISA clients. Instead, WAM sold the security at prices well below par in May and June 2009, resulting in substantial losses to client portfolios. More importantly, WAM did not notify its ERISA clients that Glen Meadow had been allocated to their accounts in error until more than a year after it had sold the position across all accounts. By negligently buying Glen Meadow for certain of its ERISA clients, delaying disclosure of its error and failing to promptly reimburse its clients, WAM engaged in a transaction, practice or course of business which operated as a fraud or deceit upon its clients.

WAM's Violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 Thereunder

23. As a result of the conduct described above, WAM also willfully violated Advisers Act Section 206(4) and Rule 206(4)-7 thereunder. Rule 206(4)-7 requires investment advisers to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and its rules. The Commission has stated that an adviser's failure

[2] A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

"to have adequate compliance policies and procedures in place will constitute a violation of our rules independent of any other securities law violation." Compliance Programs of Investment Companies and Investment Advisers, Advisers Act Rel. No. 2204, 68 F.R. 74714, 74715 (Dec. 24, 2003) ("Compliance Release"). The Compliance Release further provides that "[t]he policies and procedures should be designed to prevent violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred." 68 F.R. at 74716. The Compliance Release also states that "[e]ach adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks." 68 F.R. at 74716.

24. WAM's compliance policies and procedures required it to notify its clients of any breaches or errors resulting in a loss and to make clients whole for such losses. WAM's error correction policy applied to allocation and coding errors. In implementing this policy, however, WAM determined that the allocation of Glen Meadow to ERISA accounts did not trigger the notification or reimbursement provisions of WAM's error correction policy. By applying a narrow definition of the term "error" under its error correction policy, WAM was able to conclude that a coding and allocation issue affecting 99 ERISA client accounts did not require disclosure. As a result, WAM did not notify its ERISA clients that it had improperly allocated Glen Meadow to their accounts for nearly two years. WAM therefore violated Rule 206(4)-7 by failing to implement policies and procedures reasonably designed to ensure that errors and breaches are promptly corrected and disclosed to affected clients.

Respondent's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

Respondent has undertaken as follows:

25. Distribution to Clients.

a. Respondent has assessed how the Glen Meadow coding error affected ERISA clients. Using a methodology not unacceptable to the Commission staff, Respondent determined that 89 of Respondent's ERISA clients[3] were impacted by their holdings of the Glen Meadow securities based on a methodology comparing the performance of Glen Meadow and

[3] While 99 accounts were impacted by WAM's allocation error, WAM has reimbursed one client for Glen Meadow-related losses for guideline breaches in two of that client's accounts, and eight other accounts were closed, transferred, or did not hold the Glen Meadow security on the date WAM received notice of its allocation error. The Respondent's methodology for calculating client impact takes into account the prior reimbursement, and the Distribution does not include the seven clients with accounts that were closed or transferred prior to the date WAM received notice.

the performance other corporate financial bonds held by such ERISA client accounts during the relevant period.

b. Respondent has undertaken to make, within 60 days of the date of entry of this Order, a payment to the affected ERISA clients in the amount of $9,620,392 (the "Distribution"). This payment represents an approximation of the amount by which such clients were impacted as a result of the conduct set forth in this Order, plus reasonable interest.

c. Respondent shall be responsible for administering the payment of the Distribution to the 89 affected ERISA clients. Respondent shall:

i. deposit the amount of the Distribution into a segregated account such as a separate bank account (the "Distribution Account") within 30 days of the date of entry of the Order and provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff;

ii. submit to the Commission staff, within 30 days after the date of entry of the Order, a distribution plan ("Distribution Plan") that identifies (1) each ERISA client that will receive a portion of the Distribution, (2) the exact amount of that payment as to each client, and (3) the methodology used to determine the exact amount of that payment as to each client; and

iii. complete payment of the Distribution to the accounts of all affected ERISA clients pursuant to the Distribution Plan within 60 days after the date of entry of the Order.[4]

d. Respondent agrees to be responsible for all of Respondent's tax compliance responsibilities associated with the Distribution and shall retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondent and the payment of taxes applicable to the Distribution Account, if any, shall not be paid out of Distribution funds.

e. Within 90 days after the date of entry of the Order, Respondent shall submit to the Commission staff for its approval a final accounting, in a form acceptable to the Commission, and certification of the disposition of the Distribution. The final accounting and certification shall include but not be limited to: (1) the amount paid to each payee, (2) the date of each payment, (3) the check number or other identifier of money transferred or proof of payment made, (4) the date and amount of any returned payment, (5) a description of any effort to locate a prospective payee whose payment was returned, or to whom payment was not made due to factors beyond Respondent's control, and (6) an affirmation that the amount of the Distribution represents a fair and accurate calculation of the approximate impact to ERISA accounts on their holdings of the Glen Meadow security, based on a methodology comparing the performance of

[4] WAM has negotiated separate settlements of the Glen Meadow transactions with both the Commission and the Secretary of the United States Department of Labor. The Distribution reflects amounts to be paid in settlement of both agencies' respective actions.

Glen Meadow and the performance other corporate financial bonds held by such ERISA client accounts during the relevant period, plus reasonable interest. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request. Respondent shall cooperate with reasonable requests for information in connection with the accounting and certification.

f. After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval.

g. Commission staff may extend any of the procedural dates set forth in this paragraph 25 for good cause shown. Deadlines for dates relating to the Distribution shall be counted in calendar days except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

26. Independent Compliance Consultant.

a. Respondent shall retain, within 30 days of the date of entry of this Order, the services of an Independent Compliance Consultant not unacceptable to the Commission staff. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by Respondent. Respondent shall require the Independent Compliance Consultant to conduct a comprehensive review of Respondent's supervisory, compliance, and other policies and procedures designed to resolve allocation and coding errors by Respondent and its employees, including whether such policies and procedures are sufficiently detailed to constrain Respondent's discretion to determine whether such errors are subject to Respondent's Error Correction Policy. As part of its comprehensive review, the Independent Compliance Consultant will evaluate whether Respondent's Error Correction Policy adequately discloses Respondent's practices with respect to the treatment of such errors.

b. Respondent shall provide to the Commission staff, within thirty (30) days of retaining the Independent Compliance Consultant, a copy of an engagement letter detailing the Independent Consultant's responsibility, which shall include the reviews described in paragraph 26.a above.

c. Respondent shall require that, at the conclusion of the review, which Respondent shall request that the Independent Compliance Consultant complete in no more than 180 days after the date of entry of this Order, the Independent Compliance Consultant shall submit a Report to Respondent and the staff of the Commission. The Report shall address the issues described in paragraph 26.a above, and shall include a description of the review performed, the conclusions reached, the Independent Compliance Consultant's recommendations for changes in or improvements to policies and procedures for Respondent, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

d. Respondent shall adopt all recommendations contained in the Report of the Independent Compliance Consultant; provided, however, that, within 210 days after the date of entry of this Order, or within 30 days after delivery to WAM of the Report (whichever date is later) Respondent shall, in writing, advise the Independent Compliance Consultant and the staff of the Commission of any recommendations that it considers to be unnecessary, unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose, in writing, an alternative policy, procedure or system designed to achieve the same objective or purpose.

e. As to any recommendation with respect to Respondent's policies and procedures on which Respondent and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 240 days of the date of entry of this Order, or within 60 days after delivery to WAM of the Report (whichever date is later). In the event Respondent and the Independent Compliance Consultant are unable to agree on an alternative proposal, Respondent shall abide by the determinations of the Independent Compliance Consultant.

f. Respondent shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to files, books, records, and personnel as reasonably requested for the review.

g. To ensure the independence of the Independent Compliance Consultant, Respondent shall not terminate the Independent Compliance Consultant or substitute another independent compliance consultant for the initial Independent Compliance Consultant without the prior written approval of the staff of the Commission. Respondent shall compensate the Independent Compliance Consultant for services rendered pursuant to this Order at its reasonable and customary rates. Neither Respondent nor any of its affiliates shall be in or have an attorney-client relationship with the Independent Compliance Consultant and neither Respondent nor its affiliates shall seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultant from transmitting any information, reports, or documents to the staff of the Commission.

h. Except to the extent that the Independent Compliance Consultant is the same entity chosen for the Western Asset Management Company matter, AP File No. 3-15689, being settled with the SEC at the same time, Respondent shall require that the Independent Compliance Consultant, for the period of the engagement and for a period of two years from completion of the engagement, shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent or any of its present affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondent shall require that any firm with which the Independent Compliance Consultant is affiliated in the performance of his, her or its duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

27. Certification. Respondent shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Lorraine B. Echavarria, Associate Director, Division of

Enforcement, Securities and Exchange Commission, Los Angeles Regional Office, 5670 Wilshire Blvd., 11th Floor, Los Angeles, CA 90036, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

28. Recordkeeping. Respondent shall preserve for a period not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of their compliance with the undertakings set forth above.

29. Deadlines. The staff of the Commission may extend any of the procedural dates set forth above for good cause shown.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall pay disgorgement of $8,111,582 and prejudgment interest of $1,508,810, which shall be deemed satisfied on compliance with the distribution undertaking described in paragraph 25.

D. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $1 million to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Western Asset Management Company as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Lorraine B. Echavarria, Associate Director, Division of Enforcement, Securities and Exchange Commission, Los Angeles Regional Office, 5670 Wilshire Blvd., 11th Floor, Los Angeles, CA 90036.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest should not be ordered; (3) contest the amount of disgorgement and interest to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

F. Respondent shall comply with the undertakings enumerated in paragraphs 25-28 above.

By the Commission.

Elizabeth M. Murphy
Secretary

PIMCO

AGENDA

North Dakota Retirement and Investment Office (NDRIO)

Wednesday, March 19, 2014
2:15 PM – 4:30 PM

Conference Room – Monarch 840/3

Hosted by:
Stephanie King, *Executive Vice President*
Michael Chandra, *Senior Vice President* (via Video Conference)
Todd Staley, *Vice President*
Chris Cottrell, *Associate*

Guests:

David Hunter, *Chief Investment Officer*
Darren Schulz, *Deputy Chief Investment Officer*

2:15 PM – 2:30 PM	**Welcome** *AM Team*
2:30 PM – 3:00 PM	**DISCO 2 and BRAVO 2** *Josh Anderson, Managing Director, Portfolio Manager* *Carrie Peterson, Senior Vice President, Product Manager*
3:00 PM – 3:30 PM	**Unconstrained Bond Strategy** *Mohit Mittal, Managing Director, Portfolio Manager* *Ryan Murphy, Vice President, Product Manager*
3:30 PM – 4:00 PM	**Business Update** *Douglas Hodge, Managing Director, Chief Executive Officer*
4:00 PM – 4:30 PM	**Agency MBS** *Mike Cudzil, Executive Vice President, Portfolio Manager* *Jason Mandinach, Senior Vice President, Product Manager*

Joshua Anderson, CFA
Mr. Anderson is a managing director and portfolio manager in the Newport Beach office, focusing on global structured credit investments. Prior to joining PIMCO in 2003, he was an analyst at Merrill Lynch covering both the residential ABS and collateralized debt obligation sectors and was ranked as one of the top analysts by Institutional Investor magazine. He was previously a portfolio manager at Merrill Lynch Investment Managers. He has 18 years of investment experience and holds an MBA from the State University of New York, Buffalo.

Michael Chandra, CFA, CAIA
Mr. Chandra is a senior vice president and account manager in the Newport Beach office, focusing on institutional client service. Prior to joining PIMCO in 2008, he was an equity research analyst for Robert W. Baird & Company covering the diversified industrial and heavy machinery sectors. He has nine years of investment experience and holds an MBA from the University of Chicago Graduate School of Business as well as an undergraduate degree from Washington University in St. Louis.

Chris Cottrell
Mr. Cottrell is an account associate in the Newport Beach office, focusing on institutional client servicing. He holds a bachelor's degree in economics from Princeton University. He is currently a CFA Level III candidate

Michael Cudzil
Mr. Cudzil is an executive vice president and co-head of Agency mortgage-backed securities portfolio management in the Newport Beach office. He is the lead portfolio manager on PIMCO's Mortgage-Backed Securities Strategy. Prior to joining PIMCO in 2012, he worked as a managing director and head of pass-through trading at Nomura. Mr. Cudzil previously held similar roles at Bank of America and Lehman Brothers, as well as a senior trading position at Salomon Brothers. He has 16 years of investment experience and holds a bachelor's degree in political science from the University of Pennsylvania.

Douglas M. Hodge, CFA
Mr. Hodge is a managing director in the Newport Beach office and PIMCO's chief executive officer. He also serves on PIMCO's executive committee and on the global executive committee for Allianz Asset Management, the governing body of asset management for the Allianz Group. Previously, he served as PIMCO's chief operating officer. Earlier, Mr. Hodge led the Asia Pacific region from the firm's Tokyo office from 2002-2009. He joined PIMCO in 1989 and has previously served the firm as a senior account manager responsible for client relationships worldwide and as a global product manager. Mr. Hodge currently serves on the board of the Securities Industry and Financial Markets Association. He has 28 years of investment experience and holds an MBA from Harvard Business School. He received an undergraduate degree from Dartmouth College.

Stephanie L. King, CFA

Ms. King is an executive vice president and account manager in the Newport Beach office, focusing on U.S. institutional investors within the public client practice. Previously at PIMCO, she worked with a variety of institutional client types and co-headed the U.S. corporate client practice. Additionally, she led the firm's global recruiting function as part of PIMCO's business management group and worked on a variety of talent management initiatives. She currently serves on the steering committee for PIMCO's global inclusion, diversity and culture initiative. Prior to joining PIMCO in 2001, she was with Morgan Stanley, Blue Capital Management and Bain & Company. She has 15 years of investment experience and holds an MBA from Stanford University Graduate School of Business and an undergraduate degree from the Wharton School of the University of Pennsylvania.

Mohit Mittal

Mr. Mittal is a managing director and portfolio manager in the Newport Beach office. He manages investment grade credit and unconstrained bond portfolios and is the current chair for the Americas Portfolio Committee. Previously, he was a specialist on PIMCO's interest rates and derivatives desk. Mr. Mittal joined the firm in 2007 and holds an MBA in finance from the Wharton School of the University of Pennsylvania and an undergraduate degree in computer science from Indian Institute of Technology (IIT) in Delhi, India.

Ryan Murphy

Mr. Murphy is a vice president in the Newport Beach office and a product manager on the absolute return and investment solutions teams. Prior to joining PIMCO in 2006, he was an interest rate trader for Sunset Securities. He has eight years of investment experience and holds an MBA from the University of Chicago Booth School of Business and an undergraduate degree from the University of Chicago.

Carrie E. Peterson, CFA

Ms. Peterson is a senior vice president and product manager in the Newport Beach office, responsible for mortgage-related strategies. Prior to joining PIMCO in 2009, she was an associate at ABN AMRO on the capital markets team. She specialized in a variety of corporate debt products, including investment grade and high yield debt, as well as private placements. Ms. Peterson also previously worked at Bank One as a member of the capital markets analyst program. She has nine years of investment experience and holds an MBA from The Wharton School of the University of Pennsylvania and an undergraduate degree from the University of Wisconsin-Madison

Todd A. Staley, CFA

Mr. Staley is a vice president and account manager in the Newport Beach office, focusing on U.S. institutional investors within the public client practice. Prior to joining PIMCO in 2011, he worked as a structured finance associate on the non-mortgage asset backed securitization team at Bank of America. He has seven years of investment experience and holds an MBA from the Kenan-Flagler Business School at the University of North Carolina as well as an undergraduate degree from the University of Cincinnati.

18 March 2014

Eric Jacobson, Senior Analyst
Active Funds Research

Michael Herbst, Director
Active Funds Research

Bridget Hughes, Associate Director
Funds Research

Morningstar's Current View on PIMCO

Still Formidable, With Areas for Improvement and A Few Open Questions

On Jan. 21, 2014, PIMCO announced former CEO and co-CIO Mohamed El-Erian would be departing the firm by mid-March 2014. Those announcements took both PIMCO and PIMCO observers by surprise. The firm announced a number of additional changes to its leadership ranks on Jan. 29, 2014.

Since those announcements, a number of media articles have focused on the fractious interactions between CIO Bill Gross and El-Erian; short-term performance challenges and outflows at a few of the firm's funds; and Gross' at-times tempestuous behavior. Those articles generally did not directly address the question of whether El-Erian's departure, Gross' behavior, or the recent leadership changes have actually impaired or benefited PIMCO's investment process and investment culture.

Over the past six weeks, we've been delving into that question in a series of extensive conversations with PIMCO's leadership. Specifically, in this memo we weigh in on two main questions:

- What is the real impact of El-Erian's departure and the recent leadership changes on PIMCO's day-to-day investment process?
- Is PIMCO as formidable an investment firm now as it was prior to El-Erian's departure?

In addition, we detail the changes we are making to our Stewardship Grade and Parent Pillar rating for PIMCO.

We will follow up in coming weeks with fund analyses and in early April with a related piece to address questions we are receiving from investors regarding individual PIMCO funds.

A Brief Synopsis of What Happened at PIMCO

In the wake of El-Erian's departure, PIMCO announced a number of changes to its leadership ranks, some on Jan. 21, 2014[1], and the rest on Jan. 29, 2014[2], including the following:

- Doug Hodge was named the firm's CEO, and Jay Jacobs was named president, assuming many of the noninvestment duties formerly handled by El-Erian.
- Six senior-level portfolio managers were named deputy CIOs—Mark Kiesel, Virginie Maisonneuve, Scott Mather, Andrew Balls, Mihir Worah, and Dan Ivascyn—to shoulder investment and personnel management duties formerly handled by El-Erian.
- Several of the deputy CIOs—Kiesel , Worah, and Ivascyn—as well as Tony Crescenzi, join Balls, Mather, Saumil Parikh, Christian Stracke, and Gross as permanent members of PIMCO's Investment Committee, the body charged with setting PIMCO's macroeconomic views.

1 To review Allianz's Jan. 21, 2014 press release:
https://www.allianz.com/v_1390337998000/media/investor_relations/en/announcements/140121_irrelease.pdf
2 To review Allianz's Jan. 29, 2014 press release:
http://www.pimco.com/EN/PressReleases/Pages/PIMCO-Makes-Additional-Portfolio-Management-Leadership-Appointments.aspx

- Deputy CIO Maisonneuve's primary focus will be to lead the Equity Portfolio Management Committee, and she will be immediately available to the Investment Committee to provide input for PIMCO's expanding investment platform.
- Equities portfolio manager Chuck Lahr and fixed-income generalist portfolio manager Marc Seidner left PIMCO—Lahr for personal reasons, while Seidner stepped into a new role overseeing fixed income at Grantham, Mayo & Van Otterloo.
- PIMCO alum Sudi Mariappa will be rejoining the firm as a generalist portfolio manager, from hedge fund GLG.

What Morningstar Has Done Thus Far to Assess the Situation

Thus far, Morningstar has published a number of videos, articles, and fund analyses touching on the impact of these changes—a list of those pieces can be found in the Appendix to this memo.

Since the changes were announced, Morningstar analysts have been in frequent contact with PIMCO's senior leadership, including Gross, Worah, and other portfolio managers directly or indirectly affected by the changes. We've also had extensive conversations with other members of PIMCO's leadership, including CEO Hodge. These conversations culminated in an on-site visit to PIMCO on March 10, 2014.

Given our current view, we have lowered the Corporate Culture component of PIMCO's Morningstar Stewardship Grade for Mutual Fund Firms[3] to C from B. We have also lowered the firm's Manager Incentives component to C from B, reflecting a lower percentage of the firm's mutual fund assets in which at least one of the fund's managers invests in fund shares worth more than $1 million, the highest ownership level reported to the SEC. As a result of those changes, PIMCO's overall Stewardship Grade falls to C from B, with an A grade being the highest possible and F the lowest. We have appended the full text and scoring for PIMCO's current Stewardship Grade to this memo.

On a related note, PIMCO's Parent Pillar score—one of the five pillars of the Morningstar Analyst Rating for Funds[4]—falls to Neutral from Positive.

What Morningstar Is Doing Next

The changes to PIMCO's Stewardship Grade and Parent Pillar score do not automatically affect PIMCO funds' overall Morningstar Analyst Ratings for Funds, yet it is logical to assume that Morningstar analysts would move quickly from here to reassess those ratings on a fund-by-fund basis. We are preparing a follow-up piece for early April 2014 that will summarize our current opinions on individual PIMCO funds. In that piece we'll also answer a number of PIMCO-related questions that we have been receiving most frequently from investors.

3 To review the Morningstar Stewardship Grade for Mutual Fund Firms methodology:
http://corporate.morningstar.com/US/documents/MethodologyDocuments/MethodologyPapers/StewardshipGradeMutualFundFirmsMethodology.pdf
4 To review the Morningstar Analyst Rating for Funds fact sheet:
http://corporate.morningstar.com/US/documents/MethodologyDocuments/FactSheets/AnalystRatingforFundsFactSheet.pdf

Appendix

Morningstar's Pieces on PIMCO Leadership Changes

PIMCO Aims to Ease Succession Worries, Video Report, Eric Jacobson, Jan. 29, 2014:
http://www.morningstar.com/cover/videocenter.aspx?id=632401

More Questions About PIMCO in the Post El-Erian Era, Fund Spy, Eric Jacobson, Feb. 6, 2014:
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March 18, 2014

Stewardship Grade Scorecard PIMCO

Corporate Culture:	**C**
Fund Board Quality:	**C**
Fund Manager Incentives:	**C**
Fees:	**C**
Regulatory History:	**Neutral**
Overall Stewardship Grade:	**C**

Appendix – Morningstar's Stewardship Grade for PIMCO

PIMCO Stewardship Grade -- C

The investment community was taken by surprise in January 2014 by CEO and co-CIO Mohamed El-Erian's decision to leave PIMCO. The firm quickly named longtime employees Doug Hodge as CEO and Jay Jacobs as president. Concurrently, it designated two deputy CIOs (naming four more within about a week), made additions to its Investment Committee, and reassigned El-Erian's investment and personnel management duties. Those adjustments were designed to help ensure a degree of continuity for the investment approach that has proved to be successful for many investors in the past.

There's reason to believe PIMCO can thrive going forward given the qualifications of its new deputy CIOs and its deep research resources. Yet it will take time to assess whether recent changes prove beneficial for investors. It's also an open question how effectively the firm will navigate a tougher environment for fixed income. Despite PIMCO's prowess, relatively high expenses on many of its funds' noninstitutional share classes have historically kept it from garnering Morningstar's highest marks. Arguably, its funds' boards have not done all they could do to aggressively negotiate for better economies of scale. In addition, the firm no longer stands out versus rivals in terms of its managers' investment in the funds they run.

These issues, plus the uncertainty associated with the recent disruptions, result in a Neutral rating.

Corporate Culture – C

In many ways, PIMCO has long had a standout corporate culture. Chief investment officer Bill Gross is the founder around whom PIMCO was built, and his essential nature as an investor, above all else, has been a critical foundation for the firm.

The firm's public reputation was shaken in January 2014 following the announcement that CEO and co-CIO Mohamed El-Erian would be leaving PIMCO in March. Much of what was publicized after El-Erian's announcement can arguably be viewed as tabloid fodder, but his resignation, combined with other departures in recent years, has helped drive material changes in PIMCO's corporate culture.

In the years leading up to El-Erian's departure, the firm had experienced a number of other changes in its senior investment leadership. Two under-the-radar departures occurred in 2008 and 2009, for example, when Pasi Hamalainen retired and Zhu Changhong was recruited by the Chinese government to run its then-$2.5 trillion in foreign-exchange reserves, respectively. Neither Hamalainen nor Zhu's name was attached to high-profile mutual funds, but each had been a member of PIMCO's Investment Committee (then an even-smaller, more exclusive group than it has since become) and had been widely considered to be a valuable contributor to the firm's investment strength in his own right. Veteran generalist manager Bill Powers left the firm in 2010, and, although his focus on institutional accounts meant he wasn't well known to mutual fund investors either, he, too, had been a very senior member of the Investment Committee. Another former member of that group, Paul McCulley, held tremendous responsibility as watcher-in-chief of the world's central banks, leader of the firm's cyclical economic forums, and head of PIMCO's short-term bond desk before he retired at the end of 2010. There were other notable departures of successful managers over the same years, including those of high-yield desk leaders Ray Kennedy (2007) and Mark Hudoff (2009), Treasury Inflation-Protected Securities luminary John Brynjolfsson (2008), global-bond specialist Sudi Mariappa (2011), and government-mortgage maven Scott Simon (2013).

The last very senior-level member of the Investment Committee other than El-Erian and Gross, long-tenured PIMCO veteran Chris Dialynas, made a November 2013 announcement that he would be taking a sabbatical beginning in early 2014. Whether temporary or not, Dialynas' loss is especially notable given his reputation as something of a "glass-half-empty" kind of guy in contrast to--and as an important foil to--Gross, who sees himself as more of an optimist when looking at economic and investing landscapes.

Morningstar had weighed the potential impact of each departure over the past six-plus years. And while some were more worrisome than others, PIMCO has always had a deep enough bench to withstand the changes; that confidence in its staffing, and in Gross, has historically proved to be well placed.

El-Erian's departure was clearly a game changer for several reasons, though. Most obviously, he was Gross' hand-picked and named successor, suggesting that he would likely take over as sole chief investment officer whenever Gross was to step down. Furthermore, his departure, coupled with the uncertainty surrounding Dialynas' return, meant that no single remaining member of the Investment Committee had the kind of senior-statesman profile of those who had departed in recent years. Meanwhile, El-Erian protege Marc Seidner, who had taken on increasingly greater responsibilities during his tenure at the firm, announced his own departure from PIMCO immediately after El-Erian's was made public.

That litany of defections may look alarming when assembled in a single narrative, but it is arguably less of a worry than it might seem. PIMCO's case for depth is compelling, boasting more than 200 people in portfolio management roles around the globe, and among them at least 70 considered key contributors with a median average of roughly 17 years of experience. In addition, PIMCO's demonstrated history of picking leaders to fill in for those who have moved on suggests the firm has proved to have an uncanny ability to thrive in the wake of key personnel losses.

In the wake of El-Erian's resignation, the firm appointed six deputy chief investment officers, three of whom--Mark Kiesel, Dan Ivascyn, and Mihir Worah--were concurrently added to the Investment Committee. New deputy CIOs Andrew Balls and Scott Mather were already on the committee, while equity-group leader and newly named deputy CIO Virginie Maisonneuve effectively became an adjunct member. At the same time, central-banking maven Tony Crescenzi, who like colleague Saumil Parikh, took over important roles following Paul McCulley's retirement, also joined Parikh and the others as a full-time member of the committee. PIMCO has said that the appointment of new deputies was actually an idea developed and championed by El-Erian before he stepped down.

That new blood brings much more than fancy new titles to the table, and each member of the Investment Committee brings a resume of impressive accomplishments. Like Parikh's, Crescenzi's name became more well-known following McCulley's retirement, and he already had more than 30 years of experience and five books under his belt. Worah's star had already been shining as well, with impressive results from PIMCO Real Return PRRIX and other inflation-protected offerings. Balls' reputation has revolved a great deal around his knowledge of and experience with global economics, while Mather has shone with excellent performance records at several, mostly global-bond-focused portfolios. Meanwhile, Mark Kiesel and Dan Ivascyn have each taken home a Morningstar Fund Manager of the Year Award:

Kiesel for his work on PIMCO Investment Grade Corporate Bond PIGIX in 2012 and Ivascyn for his work on PIMCO Income PIMIX in 2013 with comanager Alfred Murata.

From the perspective of PIMCO's culture, the biggest question about this chain of events is whether the atmosphere within which the firm's current Investment Committee and broader investment team work will remain conducive to its success. That atmosphere has long been characterized as a pressure cooker, yet it remains an open question whether the current Investment Committee members--several of whom are a bit less seasoned than their predecessors--will consistently voice their opinions and fuel the debate that has been crucial to PIMCO's past success. That may prove daunting, given Gross' at-times severe and reputed retaliatory temperament.

Even so, PIMCO's power structure looks very different in the wake of El-Erian's resignation. The firm has strong and capable corporate leaders in the form of CEO Doug Hodge, president Jay Jacobs, and six very capable deputy CIOs. In addition, by his own account, Gross has acknowledged that he understands the risk an unhealthy culture can pose to the organization and concedes that PIMCO has room to improve. He has thus taken concrete steps to encourage greater dialogue and debate within the Investment Committee: In a break from the past, each of the deputy CIOs is charged with leading committee meetings on a rotating basis, so Gross heads only one out of every seven meetings. In addition, each of the new deputy CIOs now oversees several portfolio managers and, by extension, all of the specialist desks and the assets for which each skipper is responsible, thus taking on most of the personnel management duties that had previously fallen on El-Erian.

It's crucial to note that PIMCO's essential investment process remains at the core of everything the firm does. The tone was set early on by Gross, who favored a total-return approach to bond investing, which has since become de rigueur but that was novel as recently as the early 1990s. Those investing with Gross have often found themselves looking at comparatively modest income payouts but total returns that have almost always been much better than average.

Although the complexity of PIMCO's strategies, tactics, and favored investing tools often lends an aggressive flavor, a fierce attention to risk is built into the firm's investment and operational processes. The workings of PIMCO's Investment Committee illustrate the relationship between its approaches to performance and risk control. The committee typically meets four times per week, for hours at a time, to debate matters of the market and economics. Other colleagues are invited to come to present ideas, while some rotate through for stints on the committee in order to encourage a diversity of views. PIMCO outsiders are also brought in to make presentations, and managers are given incentives to second-guess the Investment Committee.

In theory, dialogue within the Investment Committee may be more open than it had been prior to El-Erian's departure, but it will take time to determine whether PIMCO's recent leadership changes and Gross' apparent change of heart will truly produce better investing outcomes.

Meanwhile, there remains a process in place to replace Gross as CIO when the time comes, and he believes that the most likely candidates are now those filling PIMCO's deputy CIO roles. The firm isn't likely to name anyone as an intended successor, however, before the need actually arises to appoint one, and it seems in the realm of possibility that competition for the slot could prove contentious. Other important questions, of course, are whether any of those newly appointed folks would even be a good fit for the role and whether any would be ready to take over from Gross should that need arise much sooner rather than later.

There are, of course, plenty of other issues relevant to PIMCO's culture. The firm has been more prolific in its rollout of new funds in the past few years, for example, and, despite its very anemic record with new equity-focused offerings in particular, the deliberate style with which the firm has done so has been, and continues to be, indicative of a mostly investor-friendly culture. PIMCO does not have a record of rolling out niche funds simply to take advantage of popular trends. Rather, most have been driven by ideas and developments in institutional management or, in some cases, developments in financial markets that have made one strategy or another newly feasible.

One area with which Morningstar continues to harbor some concern is size. Even in the wake of notable redemptions in 2013, PIMCO Total Return PTTRX still comprised more than $235 billion in investor assets as of February 2014 and remains the world's largest actively managed mutual fund. Meanwhile, Gross himself manages approximately $470 billion. That girth has by Gross' own admission made managing Total Return more challenging, though the redemptions appear to have neutralized some of the past focus on its size, and he points to long-term performance as the ultimate measure of that question. That's a credible claim despite the fund's size given that it has been the largest, or among the largest bond funds in existence for a long, long time, and its long-term risk-adjusted record has remained strong.

Even despite PIMCO's 2011 and 2013 stumbles, it's clear that Gross has adapted better than almost any other manager ever has to massive asset growth, certainly among bond funds, and there's scant evidence to suggest that those years' setbacks had anything to do with limitations from the firm's size. Gross' command of big-picture macroeconomic and sector themes has been at the root of that success, especially as PIMCO's size has expanded. Whatever the image that his latest personality tribulations have projected in the wake of El-Erian's departure, there remains good reason to believe he can persevere and his success persist.

Even at its modestly reduced asset base, however, the impact of Total Return's size remains a question that Morningstar continues to study and examine. Meanwhile, many investors have raised the question of how that fund would fare should redemptions spike back up to their 2013 pace or worse. Given the way that Gross has managed the portfolio in recent years, though, investors have good reason for confidence. He has traditionally focused plenty of fund assets in very, very liquid securities, including Treasuries, agency-backed mortgages, and even cash. Gross notes, in fact, that between bond interest payments, mortgage principal flows, bond maturities, and calls, so much cash comes in every day that meeting even the sizable redemptions from 2013 was an easy exercise.

In the meantime, there are other in-house examples of PIMCO funds whose size does raise even stronger questions about the firm's unwillingness to close large funds. Even with a smaller portfolio than it boasted a couple of years ago, PIMCO High Yield PHIYX, with more than $15 billion in assets as of February 2014, is the second-largest chunk of fund assets in the category if combined with $3.3 billion sibling PIMCO High-Yield Spectrum PHSAX, and PIMCO manages additional high-yield assets in other funds and institutional accounts. Unlike Total Return, whose fortunes are more tied to macroeconomic and sector calls, these two funds are arguably much more dependent on bottom-up research and bond-picking--the kind that becomes more and more difficult to execute at a high level when a fund's size minimizes the impact of the smaller deals that dominate the at-times illiquid high-yield sector. The question for such funds is whether PIMCO sacrifices the interests of existing shareholders in favor of its own growth of assets under management.

If there is one element of the size question that does give reason for pause, though, it's the question of what might happen should PIMCO's overall business shrink, whether as a result of a loss of confidence in the firm or even simply a trend of investor rotation away from the fixed-income markets that dominate its business. That's a much more difficult puzzle to assemble given the many possible paths the situation could take and the variety of potential responses from the leadership of PIMCO or even Allianz. It's a near certainty, however, that a sustained reduction in the firm's assets under management could trigger staff reductions and potentially make it much more difficult to retain talent. It's another element of the story that Morningstar will certainly continue to monitor.

Arguably just as important to PIMCO's Corporate Culture grade is the cost picture for investors in PIMCO's noninstitutional share classes, in particular. Several are priced high relative to similarly structured peers and sometimes emphatically so relative to the economies of scale that the firm enjoys. It's difficult to pin down why this issue has failed to gain more attention within PIMCO, particularly given Gross' occasional public comments about the headwind of high fund costs--in a 2009 column he referred to 0.75% bond fund expense ratios as an "extreme absurdity."

Other PIMCO representatives have offered that the world-class caliber of its management is ample justification for its fees. There is some merit to that argument, but PIMCO's noninstitutional share classes sometimes carry fees that are simply too high to recommend, no matter how good the management. And even then, while the funds' institutional shares are competitive on a relative basis with their various cohorts, they tend to lack fee breakpoints--Total Return is a glaring example--and charge a lot more than one might expect given their size. Of all the funds in the marketplace, this enormous portfolio should by all rights boast a truly low expense ratio in its peer group. And that's really the ultimate issue, especially for a fund group that has some of the best economies of scale of any in the world.

There's no question that PIMCO's overall culture and what it has produced for investors deserve significant recognition. On some levels, this firm still approaches or achieves best-in-class status. The aforementioned cost and asset size issues, however, have been enough to keep it from earning Morningstar's highest grade for some time. And despite all of the reasons for optimism, there is a heightened level of uncertainty in the post El-Erian era surrounding the questions of whether PIMCO's latest senior staffing transitions will prove beneficial to investors; whether recent and future senior-level departures indicate a persistent side effect of the firm's pressure-cooker culture; whether that culture will improve or turn out to be malignant for PIMCO's rising stars; and even whether the prospect of rockier bond markets or anemic performance could cause the temperature to rise even further. Those areas of uncertainty, combined with the aforementioned cost and size issues, push down PIMCO's Corporate Culture grade to Neutral.

Fund Board Quality -- C

A mutual fund board's sole purpose is to act as an advocate for fundholders, helping to ensure they are treated fairly and honorably. Only mutual fund directors have a seat at the negotiating table when it comes to hiring mutual fund advisors and setting fees, for example. Most boards of directors take their responsibility seriously, but those that stand out have established a track record of independence and shareholder-friendly practices.

For the purposes of governance, PIMCO's open-end funds are divided into two groups. The PIMCO Equity Series Trust includes the firm's seven equity offerings. The PIMCO Funds Trust encompasses everything else, about 160 funds. (There are also two separate Variable Insurance Trusts and an ETF Trust.)

The equity trust recently experienced some disruption, as two of its independent trustees resigned in mid-2013 and had not been replaced as of February 2014. Vern Curtis stepped off the equity trust at the end of June 2013 but remains a director on the larger PIMCO Funds Trust. On Aug. 14, 2013, Allan Hubbard resigned, though he hadn't served on PIMCO's other open-end trust. That leaves the equity board with just three members, including interested chairman Brent Harris, who also chairs the PIMCO Funds Trust. A three-person board is quite small for such a large organization and for the industry more generally, even considering there are only seven funds currently included in this trust.

PIMCO's equity-series trustees, meanwhile, have been busy. They've not only had to contend with changes to the board but also a steady trickle of new funds--PIMCO Balanced Income is the latest entry, offered under a prospectus dated Jan. 27, 2104. PIMCO has also recently lost two of the portfolio managers it hired to launch two of the funds. Performance has been mixed. On the plus side, the equity funds are generally competitively priced.

The PIMCO Funds board has a much longer history and governs over a much larger operation, including PIMCO's flagship offering PIMCO Total Return PTTRX. This board is made up of seven trustees, five of which have been on the board for more than 14 years. Two are interested; five are independent. The good news is that, some recent performance stumbles notwithstanding, the board has overseen an extended period of excellent portfolio management and strong results for most shareholders.

Although the board's job is to oversee the funds' operations and not to manage the firm on a day-to-day basis, the board may be in for more of a test, as PIMCO likely embarks on a more challenging interest-rate environment that could have implications for performance and fund flows. At the same time, the loss of Mohamed El-Erian brings succession issues back to the forefront, though PIMCO quickly rejiggered its investment committee in the wake of El-Erian's departure announcement, perhaps signaling the candidates for Bill Gross' next heir-apparent.

Another elusive issue that falls under the board's domain is the way in which PIMCO accounts for and reports the expenses of its funds. In essence, the firm breaks down the bulk of its funds' costs into the two large line items of "investment advisory fees" and "supervisory and administrative fees." What's especially noteworthy about that construct is the parity between those two line items. The firm's flagship Total Return fund places the issue into sharp focus.

For the fiscal year ended March 2013, Total Return's advisory fees totaled more than $685 million, while its supervisory and administrative fees clocked in at $656 million. The proximity of those numbers is perplexing simply because the first number should represent what shareholders are paying for the expert, value-added services of an active money manager, while the second should account for the relatively commodified costs that are otherwise associated with operating a fund and servicing shareholder accounts. Even if one were to argue that some providers of "supervisory and administrative" services warrant more compensation than others, it doesn't make sense that the true cost of servicing one of the best-run mutual funds in the history of the business is anywhere remotely close to the fair value of its investment advisory services. Ultimately, though, it's a matter of transparency and allowing shareholders to understand whether the board is doing enough to make sure that investors aren't overpaying for commodified services, and while the annual report does describe what kinds of expenses are included in the "supervisory and administrative fees" line item, it does not break down those costs, as other competitors do.

That said, PIMCO and the board both argue that investors should look past the technical nature of these breakdowns and simply evaluate fund costs as they appear in total. That's not an entirely problematic suggestion for the firm's institutional share classes, whose price tags are generally reasonable. But it doesn't quite address the issue with regard to many of the firm's other share classes, which carry fairly high total expense ratios. By and large, fees for PIMCO share classes sold through advisors or directly to investors (as opposed to institutional classes) are not competitive. PIMCO argues that the high returns generally produced by management justify the premium prices charged by PIMCO funds. The firm's assets under management and the funds overseen by this board have grown tremendously, though--even in just the past year--and several are among the largest in their respective categories.

The ultimate problem, however, is that it really doesn't, and shouldn't, matter how PIMCO would like to position its fund costs. It's up to the funds' board to oversee such issues in a way that best serves shareholders. The opacity of these data, combined with its girth, suggests that the board has not done all that it can to aggressively negotiate for better economies of scale or to at least help investors better understand why the fees they pay are appropriate. That includes not only making sure that cost data are transparent but also that shareholders are getting the best deal possible for the services that are being provided.

Fund Manager Incentives -- C

Portfolio managers who invest alongside their fundholders not only show a conviction in their investment approach and portfolios, but also are better able to share in a true fundholder experience as they endure the same tax and cost consequences as their shareholders. Further, Morningstar's research has found that portfolio managers who invest significantly in their funds simply perform better on average, particularly on a risk-adjusted basis. For these reasons, Morningstar's Manager Incentives grade is determined primarily by how heavily and predominantly a fund family's managers own the funds they oversee. Specifically, Morningstar considers what percentage of assets are in funds in which at least one portfolio manager has at least $1 million invested (the highest ownership range reported to the SEC).

PIMCO has just more than half of its assets, 58%, in funds in which at least one manager has more than $1 million invested, thus earning it a C for Manager Incentives. That's a drop from its last grade, when it barely eked into above-average territory with 60% of assets in funds in which at least one manager had more than $1 million invested.

Mohamed El-Erian's recent departure from the firm affects this figure, as his more-than-$1 million investments are now excluded from this calculation. El-Erian's old charges have new managers as of the end of January 2014; an amendment to the most recent Statement of Additional Information reports they have no investment in those funds as of the end of February 2014.

Otherwise, PIMCO's manager-investment story is a mixed bag.

Of course, that Bill Gross has more than $1 million invested in PIMCO Total Return, which represents just under half of the firm's open-end fund assets, goes a long way in explaining its Manager Incentive figure. Gross is listed on more than a dozen funds but, according to the funds' most-recent Statements of Additional Information, invests in only PIMCO Total Return.

To some extent, a smaller manager investment may be expected at a predominantly fixed-income shop. It's not unreasonable to expect limited investment in municipal-bond funds, for example, or other narrowly focused fixed-income funds. Nonetheless, several of PIMCO's funds, representing just under 20% of assets, have no manager investment at all, though those do include some of El-Erian's old charges on which there are now new managers. One standout, though, is Vineer Bhansali, who invests $100,001-$500,000 in four of the target-date funds that he runs. A handful of other managers do have investments above the $1 million mark.

Morningstar also considers a firm's manager-compensation plan in its manager-incentives assessment and may factor in particularly strong or deficient characteristics of such setups. PIMCO's plan, however, neither boosts or detracts from its Manager Incentives score.

As is common in the fund industry, PIMCO's manager compensation can be broken down into three pieces: base salary, a bonus, and equity or long-term incentive compensation. Although a series of positive factors may be considered when determining managers' earnings, they may also receive compensation tied to the performance of the firm, which can be seen as a potential conflict of interest, insofar as the interests of firm stockholders and fund shareholders may be misaligned. Furthermore, compensation for portfolio managers can also be linked to the amount and nature of assets managed by the portfolio manager, which can act as incentive for managers to take shortcuts to chase performance or overgrow assets.

PIMCO's compensation plan can also be linked to performance, which is a plus for shareholders. Specifically, it's based on one-, two-, and three-year dollar- and account-weighted pretax investment performance versus predetermined appropriate benchmarks. That said, a compensation structure that stresses longer-term investment performance would better align managements' interests well with those of fund shareholders, and Morningstar notes a trend toward including five-year results in portfolio-manager bonus schemes. On the whole, PIMCO's manager-compensation structure has its pluses, but its potential focus on size of assets and short-term performance are notable shortcomings.

Fees -- C

Morningstar calculates a fund family's Fees grade based on the average Morningstar Fee Level percentile for all the family's funds. These percentiles compare each fund share class with similar share classes of funds in the same fee-level group, ranging from 1 (for the cheapest funds in each group) to 100 (for the most expensive). To find a family's overall fee-level percentile, Morningstar takes the straight average of the fee-level percentiles for all the funds in the family, counting each share class separately.

Morningstar's research indicates that a fund's price tag is among the best predictors of its future relative performance. Funds with below-average price tags are likely to outperform typical rivals; those with above-average expense ratios are more likely to underperform.

PIMCO's Average Fee Level is 49 and thus earns the firm a C for Fees overall. The firm has a fairly even distribution of share-class fee levels, with roughly 20% of share classes populating each of Morningstar's five groupings--Low, Below Average, Average, Above Average, and High.

For the most part, PIMCO's institutional share class expense ratios are low or below average; however, they require a $1 million minimum investment, though investors may find them in their 401(k) plans. Many of PIMCO's A share classes are also low or below average. In many cases, the Institutional and A share classes together represent each fund's largest portion of assets, so PIMCO is giving the majority of its fundholders a good deal, relative to competitors.

Meanwhile, PIMCO's "PLUS" series of funds, such as its StocksPLUS funds, tend to run with expense ratios that are Low or Below Average. These funds are essentially index funds backed by actively managed collateral, so it stands to reason that they would be cheaper than their category peers. Also, PIMCO's small suite of fairly young equity funds is competitively priced, as PIMCO looks to break into the crowded field of active-equity managers.

However, the firm's no-load D shares tend to be Above Average or High. Furthermore, the firm's target-date series, which, granted, is quite small, is not competitively priced compared with other target-date series.

Of particular note, though, is the curious case of PIMCO Total Return, the industry's largest fund with more than $235 billion in assets as of the end of February 2014. As suggested above, that fund's Institutional and A share classes both carry Below-Average expense ratios; its other share classes, though, are Average to High. However, a fund so large might have further economies of scale to pass on to fundholders of all share classes. There appear to be no management-fee breakpoints, according to the fund's most recent Statement of Additional Information. At the fund's level of assets, such breakpoints could have a meaningful impact on its expense ratio.

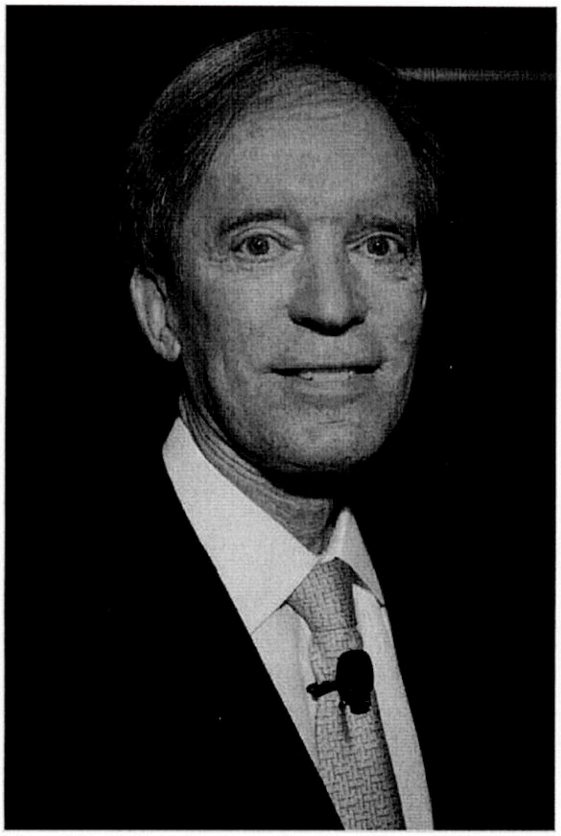
Regulatory History -- Neutral
Because investors should expect fund companies to comply with laws and regulations, the highest Regulatory History rating a firm can receive is Neutral. PIMCO has not had any material regulatory infractions in the recent past, so it gets full credit for Regulatory History.

Pensions&Investments

Drama, poor performance haunt PIMCO

Consultants, clients closely watch firm deal with alleged Gross, El-Erian feud

By: Randy Diamond
Published: March 17, 2014



Andrew Harrer/Bloomberg

Some fear that William H. Gross isn't concentrating enough on investing.

In less than two months, PIMCO has experienced a dramatic fall from grace that removed the firm from the recommended list of some investment consultants and put it on the watchlist of some asset owners.

That reversal of fortune began shortly after the Jan. 21 resignation of Mohamed El-Erian, CEO and co-chief investment officer, the heir apparent to PIMCO founder and its acknowledged leader, William H. Gross.

Newport Beach, Calif.-based Pacific Investment Management Co. has been plagued by poor performance in its flagship Total Return Fund, managed by Mr. Gross, who shared the co-CIO title with Mr. El-Erian.

But outbursts attributed to Mr. Gross earlier this month have raised fresh concerns.

"I'm so sick of Mohamed trying to undermine me," Mr. Gross was quoted as saying in a March 7 Reuters story, claiming Mr. El-Erian was behind an earlier story in The Wall Street Journal that described a tense, deteriorating relationship between the two men over investment performance issues in 2013. Mr. Gross also implied in the story that he had been monitoring Mr. El-Erian's phone calls.

"It's kind of shocking what is occurring," an investment consultant said about Mr. Gross' comments.

The consultant — who spoke on condition of anonymity — is worried Mr. Gross is not fully concentrating on his investment responsibilities. "We would be hard-pressed to recommend PIMCO to a client seeking a fixed-income manager," said the consultant, adding he would not recommend PIMCO as a finalist or even include the organization in searches for new managers.

Other consultants say they have PIMCO on watch and are monitoring events. But although some said they have reservations about recommending clients do business with the firm, they added that PIMCO would be considered in searches for strategies with strong investment performance.

But consultants say their clients are also concerned. With PIMCO under a media microscope, asset owners are concerned that doing business with the firm could bring unwanted attention, possibly creating headline risk and/or job risk for them.

"Creates a problem'

"Any time you have a management team at a money management firm generating this kind of negative press, it creates a problem," said the CIO of a public pension fund with more than $1 billion invested with PIMCO. "It creates drama. I have had more than 20 press calls that I had to deal with."

The CIO, who spoke on the condition of anonymity, said he has no plans to terminate PIMCO. He added, however, he would not give the manager a new allocation. Plus his fund has put PIMCO on a watchlist. The CIO added that he wonders whether PIMCO's leaders are able to concentrate effectively on investment performance given the distractions.

According to accounts from fellow employees, Mr. Gross has run a very top-down organization, making it clear he was in charge. Former employees familiar with both men said Mr. Gross' aggressive management style led to the conflicts with Mr. El-Erian.

PIMCO public relations staff refused requests for on-the-record interviews with Mr. Gross or other senior officials. In a statement, Thomas Otterbein, managing director and head of institutional Americas, said the firm continues to attract institutional clients.

"We have clear indications that clients and consultants continue to view us as a strong provider of investment strategies and solutions," he said in the statement. "In fact ... we have been awarded more than $3 billion in new mandates (so far this year) across a range of strategies. In addition, we are regularly being included in search activity; more than 70 RFPs so far in 2014, a 15% increase over this time last year."

PIMCO did not release flow numbers for its institutional strategies. But data from Morningstar Inc., Chicago, which tracks PIMCO open-end mutual funds including institutional-class shares, showed those funds had net outflows of $2.49 billion in February, the largest combined total in the industry for a fund group but not a big number. Those interviewed for this story attribute the February outflows to performance and a secular move away from fixed income. It's too early for the Gross-El Erian situation to be a factor, they said.

PIMCO's flagship Total Return Fund continues to suffer from poor performance. Last year, it lost its status as the world's largest mutual fund.

Around 65% of PIMCO's $1.9 trillion in assets are institutional. The firm has been a cash cow for parent Allianz SE, Munich, accounting for as much as one-third of Allianz' profits.

Meanwhile, competitors are seeing the Gross-El Erian drama as an opening to grab some business. One senior money management executive, who would only speak on background, said her firm's staff is aggressively calling on PIMCO's institutional clients in an attempt to convince them to switch managers.

And PIMCO executives have been mounting their own offensive. They have called or met with hundreds of their institutional clients, touting management changes that have resulted in six investment staffers being promoted to deputy CIO, all new positions.

Mr. Gross has said he remains engaged, tweeting on March 10, "No distractions here — just long-term performance satisfaction — working hard as always for clients."

Met with PIMCO

Phil Kapler, retirement plan administrator for the $3.9. billion Fresno County (Calif.) Employees' Retirement Association, said he was part of a group of public pension fund executives that met with new PIMCO CEO Douglas Hodge on March 11; the meeting was scheduled before Mr. El-Erian's departure.

Mr. Hodge told the group that media accounts of what had occurred at PIMCO were overdramatized. Mr. Kapler said Mr. Hodge stated there was no conflict between Mr. El-Erian and Mr. Gross, and that Mr. El-Erian decided to leave because he wanted a change.

He said Mr. Hodge said having six deputy CIOs will result in a flatter organizational structure and not so much command and control in one person's hands.

Mr. Kapler said Mr. Hodge offered a broader vision of PIMCO. He said officials would move the firm toward offering a full suite of investment strategies in a variety of asset classes and away from a straight core and core-plus fixed-income shop. (Past efforts by PIMCO to move beyond fixed income have met with limited success. After four years of seeking investors for active equities, those strategies make up less than 1% of the firm's total assets.)

Mr. Kapler said he came away from the meeting more impressed with the organization. He expects the board at its April 2 meeting to expand its relationship with PIMCO, hiring the firm for a tail-risk hedging overlay strategy for the entire pension fund.

"They've got the depth and breadth to manage the strategy," Mr. Kapler said. "We are not running away from PIMCO, we are getting in deeper with them."

He called the watch status routine, done every time a firm has change in the senior executive ranks. Fresno County has around $100 million allocated to emerging markets debt with PIMCO.

Other pension executives are more skeptical of giving PIMCO new business. One at a large public pension fund said his fund recently allocated around $100 million to PIMCO for emerging markets debt, its first allocation to the firm. He said he wouldn't do that today, given the current situation, because it could lead to second-guessing by his board and the local press.

"If it doesn't work out, it looks like you don't know what you are doing," he said.

Two consultants also expressed concern that Mr. Gross is stretching himself too thin. (He took over as portfolio manager of the $25.6 billion PIMCO Unconstrained Bond Fund in December, replacing longtime manager Chris Dialynas, who took a one-year sabbatical.)

Mr. Gross promptly changed the fund's strategy, according to the firm's website, selling 30-year Treasuries and a large portion of its agency mortgage holdings while increasing bets on corporate debt.

One consulting firm that has PIMCO on watch is Angeles Investment Advisors, Santa Monica, Calif. Michael Rosen, principal and CIO, said any time there is a change in senior management it has the potential to be distracting to the organization and affect the investment process.

Mr. Rosen said he has not put PIMCO on a unilateral blacklist; it depends on the strategy and specific investment performance. He said the PIMCO income strategy managed by Daniel Ivascyn, one of the new deputy CIOs, has done very well. Several clients are invested in the strategy, he said.

Mr. Rosen said PIMCO has a deep investment bench that goes beyond Mr. Gross, but in the end, what will make or break PIMCO is one thing. "It all comes down to investment performance," he said.

Original Story Link: http://www.pionline.com/article/20140317/PRINT/303179981/drama-poor-performance-haunt-pimco-consultants-clients-closely-watch-firm-deal-with-alleged-gross-el-erian-feud

Agenda Item III. D.

State Investment Board

Custody Review Recommendation

March 28, 2014

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Trust, Custody & Securities Lending Review Summary

North Dakota - State Investment Board

Retirement & Investment Office

Trust, Custody and Securities Lending Review

Initial Candidates and Finalists:

Callan Associates	**Mark Kinoshita, Virgilio "Bo" Abesamis III << FINALIST**
Hewitt Ennis Knupp	**Kristen Doyle, Stephen Cummings << FINALIST**
Mercer	Brian Birnbaum, Glenn Ayers
R.V. Kuhns	Jonathan Kowalik, Ron Klotter / Kristen Steffens
Towers Watson	Diane Cook, Steve Carlson

Primary Selection Criteria:

1.) Major Investment Consulting Firm

2.) Expressed Interest in North Dakota / Consistently Responsive

3.) Custodian / Peer References

4.) Public Market Expertise

5.) Consistent Track Record in Perfroming Trust and Custody Reviews

Overview:

- The five candidates are all major consulting firms which expressed an interest in providing a trust and custody review.
- Callan and Hewittennisknupp ("HEK") were clearly the most consistent in their interest and responses.
- The RIO Staff deem both Callan and HEK to be market leaders in this area with "Bo" and 'Kristen" being named by both clients and competitors as true experts in this area.
- **The RIO Staff recommends Callan** given their greater knowledge of our operations, but deem HEK a close second and note that HEK has offered the service at $40,000 (vs. $60,000).

	------- Callan Associates -------			-------- Hewitt Ennis Knupp -------		
Trust, Custody and Sec. Lending Clients	# of Clients Advised	Total Assets Advised	Average Size	# of Clients Advised	Total Assets Advised	Average Size
2008	36	$210 billion	$6 billion	15	$100 billion	$7 billion
2009	51	$432 billion	$8 billion	31	$600 billion	$20 billion
2010	22	$160 billion	$7 billion	30	$75 billion	$3 billion
2011	19	$295 billion	$16 billion	14	$100 billion	$7 billion
2012	23	$190 billion	$8 billion	35	$250 billion	$7 billion
2013	37	$581 billion	$16 billion	34	$350 billion	$10 billion

HEK Trust Services Team

Custody Evaluation Capabilities and Services
March 2014

Trust Services Team

- Dedicated team of seven professionals that specialize and conduct extensive research in custody, securities lending, and transition management
- Extensive experience assisting large, sophisticated institutional investors with custody and securities lending searches
- Ongoing due diligence on custodian banks and securities lending agents
  - Conduct multiple onsite visits ever year
  - Host meetings in our offices to obtain updates and stay current in our knowledge of specialty services and products being offered
- Gain unique insights into providers' capabilities, continuity of client service, and other aspects through our extensive client exposure to the industry's top providers of custody and securities lending services
- Robust research in the related areas of:
  - Foreign exchange
  - Transaction cost analysis
  - Commission recapture
  - Private asset administration
- Customized approach to provider evaluation, search process, and deliverables
- Experience negotiating favorable fees for clients based on our knowledge of market averages for varying sizes and structures of investment programs

Custodian Evaluation Process

This applies to clients that only desire their custodian be evaluated on a stand-alone basis:

- **Collect background information:** Gain full understanding of investment program structure and reporting requirements
- **Interview key parties:** Assists us in understanding the needs and requirements of the custodial relationship
- **Determine custodian evaluation criteria:**
  - Work collectively with the client to determine the criteria that should be included in the evaluation
  - This is highly customized; one-size-DOES-NOT-fit-all when evaluating custodian relationships
  - Can develop a scorecard for evaluating the custodian
- **Send custodian customized request for information**
- **Provide client with a comprehensive report on custodian's capabilities:**
  - Includes high level information on other large, global custody bank capabilities to provide staff and other key stakeholders a way to compare their custodian to its competitors
  - Apply the actual capabilities to the evaluation criteria, and if appropriate, the scorecard
- **HEK can assist with the following potential outcomes:**
  - Contract / fee negotiation
  - Identify services needed that were not being provided previously
  - Negotiate better client service team, if appropriate
  - Develop or enhance service level agreements
  - Decide to perform formal, competitive custodian search

Custody Search Capabilities

This applies to clients that want to conduct a full competitive search process:

- **Assist clients with evaluating their custody relationship**
  - Customized approach to each custody project
  - Fully understand the structure of investment program and unique needs of the client
- **Assist clients with RFP development**
  - Maintain and regularly update a comprehensive 150 question RFP that captures most relevant topics
  - RFP tailored to the unique needs of each client
- **Partner with Staff to evaluate RFP responses**
  - Provide custom reports that compare key characteristics of custody candidates
  - Help Staff develop a shortlist of candidates as well as arrange and facilitate onsite meetings
- **Conduct in-depth custody reviews and searches**
  - Review custody providers, services, fees, and relationship team
  - Provide custody fee benchmarking and facilitate blind bid proposals
- **Contract and fee review**
  - Regularly review custody contracts and fee schedules
  - Experience overseeing the transfer of assets and services to the new custodian and ensure that all services agreed upon are being provided
- **Regular market updates**
  - Updates on regulatory issues
  - New custody industry trends
  - Other relevant topics relating to the custody industry

Custodian Bank Due Diligence

- **Formal ratings (Buy, Hold, Sell) for custodian banks (research reports available to clients)**
- **Extensive custodian bank research and due diligence**
  - Maintain internal database of information on all large and middle tier custodian banks in the industry
  - Meet onsite and in our offices with these custodian banks on a regular basis
- **Key areas of focus when evaluating custodians:**
  - Client service
  - Accounting and reporting capabilities
  - Performance measurement
  - Risk and compliance systems
  - Global custody services and foreign exchange trading
  - Cash management
  - Benefit payments and proxy voting
  - Technology and online systems
  - Derivative processing
  - New industry trends

Custodian Private Assets Capabilities

- **Leverage HEK's private asset back-office team**
  - Have expertise in private asset administration and performance reporting
  - Key element in evaluating custodian bank's capabilities
- **Key areas of focus when evaluating custodian private assets capabilities:**
  - Team composition and expertise
  - Private assets system capabilities and integration with core custody system
  - Reporting capabilities
  - Available performance metrics and portfolio composites
  - Benchmarking capabilities
  - Methodology for handling the private assets reporting lag
  - Ability to monitor compliance with partnership terms
  - Ability to look through to partnership portfolio companies

Current Themes

- **Online Reporting**
  - Key aspect of custody service offering is online access to fully customized reports
  - Dynamic, interactive, and robust daily data is key
- **High Quality Customer Service**
  - As global custody capabilities have become more commoditized, the way custody banks differentiate themselves is through client service
  - Clients' experience with a custodian is often largely dependent on the client service team and model
- **Alternative Asset Services**
  - Given the increased allocations within institutional investment plans to private asset classes and derivatives, custodians are improving their ability to accurately and efficiently process, value, and report on these asset categories
- **Unbundling Services**
  - Institutional investors are interested in finding the best service providers for each service needed
  - This has led to unbundling of services historically provided by the custodian (e.g. securities lending, cash management, foreign exchange, hedge fund administration)
- **Foreign Exchange**
  - Given recent lawsuits this is a key topic in the marketplace
  - Transparency has been lacking, but we have seen and expect to see increased transparency
- **Securities Lending**
  - Given the events of 2008, institutional investors are examining their securities lending programs
  - Move toward intrinsic lending programs with lower reinvestment risk and for some plans moving away from the custodian lender to a third party lending agent

Tech Series

- In 2012 and 2013, the Trust Services team met with each large custodian bank (BNY Mellon, JP Morgan, Northern Trust, and State Street) to evaluate the following aspects of their technology:
  - Design and structure of technology platform
  - Characteristics and organization of online portal
  - Real time data availability
  - Performance reporting
  - Look Through capability
  - Compliance Monitoring
  - Online transaction capability: cash movement, securities trading, etc.
  - Private asset reporting
- Created comparative scores for each technology platform that allows clients to easily compare the technology capabilities across providers

Evaluate Custodian Through Operational Risk Lens

- HEK also assists clients in evaluating their custodian in the context of the operational risks faced by the client given its investment structure
- Possible operational risks include:
  - Headline
  - Regulatory
  - Global Custody (sub-custodian)
  - Foreign Exchange
  - Data Management
  - Security
  - Process
  - Contract
  - Securities Lending
- Combine evaluation of custodian's capabilities with its ability to help mitigate a plan's operational risks (e.g. risk-adjusted score)
- Apply higher weight to those risks that are determined to be higher in severity
- Associate each risk identified with the appropriate evaluation criteria category (for example, the level of an organization's financial stability would be associated most directly with headline risk)

Why HEK Trust Services?

- Customization
- Significant public fund experience
- Forward thinking in our research; our research approach is constantly evolving with the changing investment and technology landscape
  - Tech Series
  - Private asset evaluation
  - Operational risk evaluation
  - Securities lending research (warned clients of risks in collateral as early as 1990s)
  - Update RFP questions quarterly/annually to be most relevant (i.e. recently added section on derivatives processing and foreign exchange capabilities)
- Comprehensive research reports and ratings

InTotal

Global Investment Management

The Northern Trust Company — Custody

Review Date	Current Rating	Previous Rating
November 2013	Buy	New Rating

Overall Rating

The Northern Trust Company ("Northern Trust") is a wholly owned subsidiary of Northern Trust Corporation (symbol: NTRS), a publicly owned company headquarter in Chicago, IL. Northern Trust was among the first banks to offer custodial services to institutional clients with the passing of ERISA in 1974. We have a favorable opinion of Northern's custody capabilities as the commitment to the industry is strong with a long history of providing institutional trust services and continued investment into the business is evident.

Component Ratings

	Rating	*Previous Rating*
Overall	Buy	*New Rating*
Business	4	*New Rating*
Staff	3	*New Rating*
Processes	3	*New Rating*
Risk	3	*New Rating*
Operations	Pass	*New Rating*
T&C / Reporting	3	*New Rating*

Firm Summary

Corporate Headquarters	Chicago, IL	**Parent Name**	Northern Trust Corporation
Current Assets Under Custody & Administration	$5.0 trillion	**Ownership**	Publicly owned
U.S. Based Custody Assets	$2.3 trillion	**Institutional Custody Staff**	10,636
Custody-Related Revenues as a % of Total Bank Revenues	64.1%	**Number of U.S. Based Custody Clients**	1,226
Primary U.S. Location of Trust and Custody Processing	Chicago, IL		

AON Hewitt

Investment Manager Evaluation

Rating Sheet		
Factor	**Rating**	**Comments**
Business	4	The Northern Trust Company ("Northern Trust") is a wholly owned subsidiary of Northern Trust Corporation (symbol: NTRS), a publicly owned company founded in 1889 and headquartered in Chicago, IL. Northern Trust has remained among the leading providers of institutional custody services since the passing of ERISA in 1974. As of March 31, 2013 Northern Trust had $5.02 trillion in assets under custody. Northern's client base is diverse, in terms of type of clients served. Based on the number of clients, Corporate and Endowment & Foundation plans make up nearly 58% while Public and Taft Hartley plans make up 20%. In terms of assets under custody, Corporate plans cover 34% of total assets followed by Public Funds at 21%. In addition to trust and custody services, Northern Trust also offers personal banking and financial services.
Staff	3	Northern Trust is known for employing long standing staff members with 31% of staff having been at the company for 10 years or more. The majority of client service staff has between 5-10 years of experience in trust and custody with many having begun their careers in the Operations & Technology group at Northern Trust. Northern's segment-based approach where Client teams are organized by plan type (Corporate, Taft-Hartley, Public, E&F, etc.) allows teams to focus on specific needs often associated with similar plan and client types. Each team has representatives with expertise who focus on their respective service offering and have clearly defined roles and responsibilities.
Processes	3	Northern Trust has adequate procedures and controls in place for securities processing and failed trade resolution. Timeliness of trade settlements utilized by straight-through-processing (STP) is able to meet client data delivery expectations. Northern also has dedicated teams suitable for servicing corporate actions, proxy, and class action activity. Clients who manage investments internally are also able to utilize services offered by Northern's Investment Manager Liaison Group. HEK is comfortable with Northern's cash management capabilities offered to clients. The short-term investment vehicles and money market funds are managed by Northern Trust's Fixed Income and Cash teams. However, there are some issues to note. Northern's diversified STIF product had exposure to Lehman Brothers and a structured investment vehicle (SIV), Whistlejacket/White Pine. In order to avoid default and any participant Fund losses, Northern Trust provided capital to support the Fund to ensure that it continued to trade at a $1 net asset value. Northern Trust Passport® is a fully integrated custody system that incorporates their custody, accounting, and performance measurement platform. The proprietary web based system is easy to navigate and allows clients to access various tools offered. Northern's accounting and reporting systems are able to provide clients accurate and timely data and information which undergoes a number of validation and quality checks. Northern's data interrogation and report writing tool, Sherlock, while able to provide custom query and reporting, is less robust than solutions offered by peers. Northern also provides a unique

Rating Sheet		
Factor	**Rating**	**Comments**
		product, Data Direct, which allows clients to access a data feed through Excel on their desktop. While Northern has been taking the appropriate steps to improve the tools and features available on Passport®, the overall custody system has yet to be as advanced as those offered by top-tier competitors. Northern Trust offers sufficient derivative services that are able to facilitate a wide range of derivate products. Clients have the option of utilizing a fully outsourced derivatives servicing model. While Northern does not have a proprietary derivatives trading platform, a number of the derivative services are provided by "best-in-class" third party providers including Markit for confirmation and matching and Lombard Risk's Colline™ for collateral management. Northern Trust's private asset reporting capabilities meet all the desired needs of the standard client. Northern utilizes The Burgiss Group to provide comparative benchmark and universe information. Northern's interactive interface is not as robust and customizable when compared to peers. Northern Trust has a staff dedicated to global custody that follow, prepare, submit, and credit tax reclamations. The global custody group is also supported by an extensive sub-custodian network covering 102 markets. These sub-custodians are continuously monitored by Northern's Subcustodian Network Management Team (SCNM) who conducts semi-annual and annual formal reviews. Clients have the option of utilizing Northern Trust's proprietary compliance monitoring system, Compliance Analyst®. Northern offers three levels of service which range from client access to Compliance Analyst® to outsourcing their entire compliance monitoring program to Northern Trust. Northern's risk reporting services are supported by MSCI BarraOne using a Fundamental Multi-Factor Model and is able to provide basic risk analysis. Basic reports include Value-at-Risk (VaR), stress tests, portfolio decomposition, portfolio optimization, and "What-if" scenarios. However, if a client would like to run customized reports, depending on complexity, may have to request that Northern Trust run the analysis on the client's behalf. Northern Trust has strong reporting capabilities. Reports and analytics are made available through Passport and supported by Investment Risk & Analytical Services (IRAS) with 280 investment professionals. Performance can be reported across all asset classes. Clients also have access to a number of universes through Mellon Analytical services, Informa's PSN manager database and Venture Economics Private Equity Universe. Northern also maintains over 10,000 indices through Rimes Technologies.

AON Hewitt

Rating Sheet		
Factor	**Rating**	**Comments**
Risk Management	3	Northern Trust has adequate security measures in place to protect unauthorized access to client account information. Northern implements the latest security technology to ensure data is protected when accessed from client's computers to the data centers where information is stored. The Corporate Data Security unit of Northern is a separate department from any operating, business or systems organization and provides an additional layer of security as all client access requests can only be authorized and set-up by the unit. Any unauthorized access attempts are also investigated by Corporate Data Security. All access requests and updates are maintained with audit trails.
Operations	Pass	Northern Trust has a dedicated operations unit, Operations and Technology (O&T), that supports the Corporate & Institutional Services (C&IS) unit. Northern has appropriate disaster recovery and contingency plans in place. Northern's external accounting firm runs an SSAE16 exam on operating controls and procedures annually. Northern received an unqualified opinion from their independent auditor regarding their most recent SOC 1 Report with no material deficiencies to note.
Terms & Conditions / Reporting	3	Our client service/consultant relations experience has been favorable. Custody fees are reasonable when compared to their peers.
Overall Rating	**Buy**	Overall, HEK has a favorable opinion of Northern Trust. The commitment to the industry is strong with a long history of providing institutional trust services and continued investment into the business is evident. Passport®, Northern's internally developed technology platform allows for simple data access and customization of reports. In addition, the various services offered with the standard custody package and added tools are on par with those offered by peers. The custody business continues to grow with net gains in client additions over the past two years. Northern continues to have a particularly strong presence supporting Corporate and Endowment & Foundation plans.

Northern Trust Profile

Overview

The Northern Trust Company ("Northern Trust") is a wholly owned subsidiary of Northern Trust Corporation (symbol: NTRS), a publicly owned company founded in 1889. Headquartered in Chicago, IL, Northern Trust operates in two core businesses: Corporate and Institutional Services (C&IS) and Personal Financial Services (PFS). Currently, the organization has approximately 14,535 employees worldwide with 10,636 of those individuals dedicated to supporting the institutional asset servicing business. As of March 31, 2013 Northern Trust had $5.02 trillion in assets under custody. U.S. based assets comprise approximately 46% of total assets under custody, while total custody clients currently stands at 1,226.

Business

Northern Trust offers the following financial services:

- Corporate & Institutional Services (C&IS), one of two main business units, provides asset administration, investment management, and information services to a wide range of institutional custody clients globally. Northern Trust's second core business unit Personal Financial Services (PFS) caters to high net worth individuals offering trust, investment management, and banking.
- The Operations & Technology (O&T) and Northern Trust Global Investment (NTGI) units support both C&IS and PFS. O&T also maintains the global infrastructure necessary for NTGI, Northern's global multi-asset class investment manager to operate.

Most recently in July of 2011, Northern Trust successfully finalized the acquisition of Omnium LLC from Chicago-based Citadel LLC. The integration of Omnium allows Northern Trust to offer a greater level of support within the Northern Trust Hedge Fund Services, LLC with technologically innovative administrative services around middle-office maintenance, real-time data monitoring, and support for high volume and complex investment strategies.

Northern Trust has maintained capital levels well above requirements. Strong capital ratio levels allow Northern Trust to pursue profitable investment opportunities to help better diversify revenue streams and maintain a sound balance sheet.

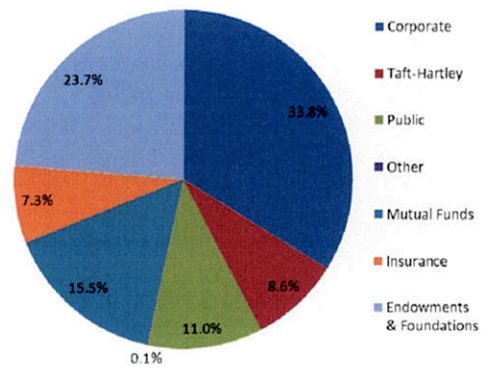
Capital Ratios as of March 31, 2013

	Current Ratios	**Requirements***
Northern Trust Corporation		
Tier 1 Capital Ratio	13.3%	6.0%
Total Risk-Based Capital Ratio	14.7%	10.0%
Leverage Ratio (to average assets)	8.4%	5.0%
The Northern Trust Company		
Tier 1 Capital Ratio	12.2%	6.0%
Total Risk-Based Capital Ratio	14.0%	10.0%
Leverage Ratio	7.7%	5.0%

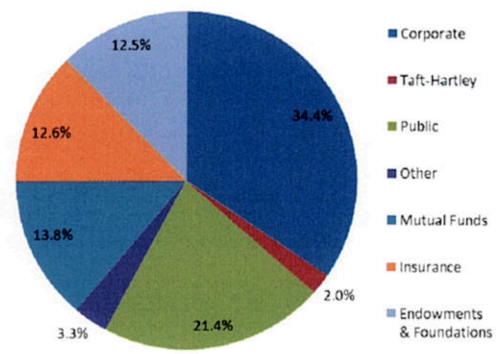
*Federal Reserve Bank regulatory capital requirements

Clients and Assets Under Custody

Client by Type



Assets under Custody by Client Type



YEAR	CLIENTS GAINED	ASSETS GAINED (US$ MILLIONS)	CLIENTS LOST	ASSETS LOST (US$ MILLIONS)
2011	98	$104,000	20	$136,800
2012	76	$87,500	39	$25,600

- As of March 2013, Northern Trust had 1,226 U.S. based clients mainly consisting of Coporate and Endowment & Foundation plans.
- Northern Trust has approximately $2.3 trillion in assets under custody for U.S. based clients and approximately $2.7 trillion for non U.S. based clients. Corporate and Public funds make up the majority of U.S. assets.
- The mean and median U.S. custody account sizes are $2.3 billion and $388 million, respectively.
- Northern Trust added more custody clients and assets than they lost over the past two years.
- C&IS (the division that includes institutional trust and custody) revenue as a percentage of total revenue for Northern Trust is approximately 34%.

Staff

Key Staff	Position	Date Joined	Years of Experience
Rick Waddell	Chairman & CEO	1975	37
Bill Morrison	President & CEO	1998	39
Steve Fradkin	President – C&IS	1985	27
Joyce St. Clair	President – O&T	1992	31
Gabe Lorenzo	General Manager Valuations and Reporting Services	1983	30
Jeff Feeney	Investment Risk & Analytical Services	2006	22

Andy Clayton	Securities Lending Program	1995	25
Nigel Bloomer	Investment Manager Liaison	1994	25
Paul d'Ouville	Head of Institutional Strategy & Development	1989	24

- Steve Fradkin, President, has been with the firm since 1985 and leads Corporate & Institutional Serves (C&IS).
- Gabe Lorenzo, General Manager, joined Northern Trust in 1983 and has held positions such as Director of Client Service for C&IS and Head of Client Service Practice for Northern's International Division. Mr. Lorenzo is currently responsible for Valuations and Reporting Services.
- Jeff Feeney manages the Investment Risk & Analytical Services (IRAS) division. Before joining Northern Trust in 2006 he managed Citigroup's Chicago Futures office.

Client Service Overview

- Northern Trust is known for employing long standing staff members with 31% of staff having been at the company for 10 years or more. The majority of client contact staff has between 5-10 years of experience in trust and custody with many having begun their careers in O&T at Northern Trust.
- Internal talent development is embedded in the Northern's philosophy and practiced across all business segments. Internal educational courses are provided to employees who are encouraged to participate as part of each individual's personal development program. External continuing education is also highly encouraged with nearly 60% of client servicing staff having an advanced degree.
- Northern Trust employs a market segment-based approach where Client teams are organized by plan type (Corporate, Taft-Hartley, Public, E&F, etc.). This allows teams to focus on specific needs often associated with similar plan and client types. Each team has representatives with expertise who focus on their respective service offering and have clearly defined roles and responsibilities.
- A Client team is typically led by a relationship manager who serves as the primary client contact. The relationship manager is supported by an account manager who oversees daily activities including cash movement, transaction activity and reporting; a servicing team consisting of individuals who focus on a specific services offered including investment risk and analytical services, accounting, benefit payments, securities lending, etc.; and a core custody team focusing on asset pricing and coding, income processing, corporate and class actions, proxy servicing, etc. To ensure fluid client delivery, each client relationship and account manager are assigned back-ups.
- The average client-to-employee ratios vary and are reasonable. Relationship managers average 5-8 client relationships based on client size and complexity. Account manager assignments range from 4-10 averaging approximately 7 client relationships. Relationship staff averages 19 years of service with Northern Trust and the team experiences minimal turnover.
- Client teams maintain a procedure manual or Service Level Description (SLD) for each client relationship which addresses special policies and processes set by clients and are reviewed at least twice a year to ensure accuracy.
- Responding in timely and accurate manner that can be tracked is the basis of finding

resolution for clients. Relationship Managers are responsible for overseeing client inquiries and internal response times. Acknowledgment of all client inquiries on a same-day basis is standard policy. Depending on the complexity of the inquiry, client teams strive for same-day resolution. All inquiries are processed through Case Management, an inquiry tool accessible through Passport®. Case Management allows for inquires to be submitted, tracked, and review.

- Northern Trust has adequate back-up procedures in the event a client service team member is unavailable. Each member is cross-trained on all aspects of services offered to assure continuity. All approved team members have access to a centralized database outlining pertinent information necessary to assist clients on a day-to-day basis.
- Clients are able to attend a number of client advisory boards hosted by Northern Trust throughout the year including Northern American Executive Forum, NTGI Client Advisory Board, Treasury Management, and Global Wealth Alliance & The Financial Executives Group. These advisory boards are geared toward discussions on industry trends, technological developments, new product initiatives, and product reviews.

Process – Securities Processing

Securities processing services involve a wide range of transaction, information, reconciliation, and funds movement processing. With increased automation and technological advancement, these services have become fairly generic in nature among the industry's leading custodians. Northern Trust is a member of the Depository Trust Company (DTC) and the Federal Reserve Bank Book Entry System (FBE). Memberships in foreign depositories include CREST in the UK and Ireland, Euroclear, and the Canadian Depository for Securities Limited (CDS). Average daily transaction volumes at the Depository Trust Company (DTC) and the U.S. Federal Reserve (FED) averaged 50,588 and 5,124 respectively in 2012.

Northern Trust's trade settlement process and procedures focus on control, timeliness, and automation. Settlement is achieved by utilizing straight-through-processing (STP) which eliminates a majority of manual handling. Settlements primarily undergo five phases which include trade capture, trade verification, trade communication, trade settlement, and registration.

- Northern Trust's trade capture offers approximately 100 trade communication links across its main operating centers in Chicago, London, and Bangalore.
- The various trade links enable a high level of automation, allows investment managers multiple options for trade communication, and provides 24-hour support.
- Once trades are captured, they go through extensive edit and verification checks to ensure accuracy.
- Trades that cannot be processed are reviewed using a number of manual and system checks including review of client details and account information, confirming the trade date is prior to the settlement date, and ensuring consistency of currency payment deposit and settlement.
- Trades that are captured and verified are sent to a pending position and have SWIFT instructions automatically created and sent to the appropriate parties. To avoid manual processing, Northern Trust supports a number of SWIFT message types.
- Each trade and transaction is confirmed by the sub-custodian via SWIFT and is required to confirm full details including settlement date, number of shares or par value, and cash amount. To ensure accuracy, cash and securities movement is reconciled daily with both sub-custodians and

depositories.

- Strict procedures are in place to ensure timeliness of settlements including failed trades. If failed trades do occur, Northern Trust will identify the reason and alert the appropriate parties. Representatives of the Investment Manager Liaison Group (IMLG) strive for same-day settlement and monitor the trade until all issues are settled. Detailed documentation is conducted to prevent recurrence and is provided intraday. This information can be accessed through Passport®, Northern's online client portal.

Approximately 80% of cash and 90% of stock positions are automatically reconciled with the remainder requiring a manual process. Northern Trust is also one of few custodians to reconcile at the transaction level rather than the position level allowing for increased accuracy and easier identification of discrepancies. All services being integrated in a single system provides a higher degree of accuracy and is also advantageous as time spent on internal reconciliations is not necessary.

Northern Trust's processes to ensure timely receipt of information relating to corporate actions such as tender offers, exchange offers, etc. is adequate.

- Over 220 staff members support corporate actions on a global basis. Corporate action events are sent via the online notification and voting system, Corporate Action Delivery & Response (CDR), via SWIFT or fax within 24 hours of receipt. CDR is an electronic notification application accessed through Passport® and has increased automated receipt of 90% of corporate actions. Northern also holds a zero tolerance policy for non-response to entitlements.
- CDR tracks details of corporate action notifications that have been sent and awaiting confirmation. Cut-off dates are closely monitored and are triggered in the event of no response.
- FT Interactive Data provides the majority of data and information for global income events. Northern Trust also relies on a number of additional sources including DTC/Fed, Bloomberg, Reuters and Daily official lists (in the UK).
- In addition to corporate actions, Northern has dedicated units for proxy notifications and class action processing. Two leading industry providers of proxy services Broadridge Financial Solutions and ISS Global Proxy Distribution supports U.S. and global proxy voting respectively.

Northern Trust also provides a full range of services dedicated to clients who manage investments internally through the Investment Manager Liaison Group (IMLG). Clients can utilize Web Trade Services (WTS) through Passport® which allows for efficient post-trade and pre-settlement trade processing around the globe.

Process - Cash Management

Northern Trust offers sufficient cash management services for clients. Cash Funds are managed by portfolio managers and a team comprised of research, trading, risk management, and strategy members. Northern Trust's Fixed Income and Cash teams also oversee the management of Northern's Money Market Funds. Short-term investment vehicles offered have reasonable fees and include cash investment accounts, fixed time deposits, short collective investment funds, money market mutual funds and high-yielding investment accounts for non-U.S. clients. Interest bearing accounts are available in 19 currencies (including USD).

- Northern's investment style emphasizes principal preservation, daily liquidity management, and yield maximization. The Portfolio Management Team and the Fixed Income Research Group collectively manage the credit quality for STIF funds and update credit quality opinions at least on a quarterly basis.

Written credit reviews are generated annually at a minimum. The Fixed Income Research Group maintains the Master Eligible List (MEL) consisting of issuers identified that are approved for managers to invest.

- Aladdin, a portfolio management system from Blackrock, is utilized to provide automated real-time compliance monitoring and checks ensuring portfolio holdings are consistent and in accordance with objectives and guidelines.
- Investment Administration and Compliance is a dedicated group within Northern's Risk Management Division that conducts post trade compliance. The group ensures that compliance of investment management accounts are in line with client guidelines and Northern's policies and procedures using Charles River Investment Management System.
- Northern Trust's diversified STIF product had exposure to both Lehman Brothers and a structured investment vehicle (SIV), Whistlejacket/White Pine. Northern Trust provided capital support to the Fund to ensure that it continued to trade at $1 net asset value to avoid default and ensure that none of the participants in the Fund experienced a loss.
- Northern Trust has appropriate controls in place to protect against fraud and unauthorized entries including maintaining a list of authorized signers, procedures for and instructions for client authentication. Cash movement utilities are secured by 128-bit encryption, non-display passwords, automatic time-outs after inactivity, and RSA SecureID token code entry.
- Web Cash Movement (WCM) is the online tool that provides clients an automated cash movement solution for methods including ACH, check issue, USD-denominated wires, and intra-account funds transfers. Commonly used transactions can be automated with "profiles" removing the need to re-create instructions. Clients may also customize user access and permission requirements, per-item and daily aggregate transactions limits, and apply multi-tier protocols for approval.
- Northern also offers Cash Forecasting through a web-based reporting package including details on actual cash, projected cash, projected overdraft, and balance summary. Forecast may be projected for up to 90 days.

Process – Systems/Data Processing

Institutional custody is primarily a technology-based business. A combination of shrinking profit margins and rapid advances in technology are challenging custodians to increase the volume of their business and to spend substantial amounts on technology maintenance and development each year.

Northern Trust's fully integrated custody system, Northern Trust Passport®, incorporates their custody, accounting, and performance measurement platforms. The system is run on a single platform that has been internally developed. All of the data processing activity is stored on the integrated platform that is utilized for internal staff, client, and investment manager information. The system consolidates data including any unique processing and timing needs required by various financial institutions and markets. In addition, custom accounting and performance reports can be generated through Sherlock, Northern Trust's data interrogation and report writing tool. Custom reports can be created on an ad-hoc basis or saved for later use.

- Northern Trust has dedicated 15%-16% of total revenue or roughly $600 million to technology spending per year. Nearly 1,590 systems staff members support data processing, programming and application development specific to the custody system. Northern Trust has projected a total of $2 billion in spending through 2015.

- A majority of the applications have been developed in house, while a select number of third party applications have been incorporated and are consider "best of breed" among the industry.
- Northern Trust has adequate technology for backup systems and data recovery through the use of data mirroring which is enabled through a private, point-to-point network. Data mirroring technology allows two copies of data to be maintained in Corporate Data Centers. Disaster recovery procedures are tested at least on an annual basis. Northern Trust has experienced an average of 10 minutes of downtime, a total of 50 minutes across 5 incidents.

Process - Account and Reporting Systems

It is essential that Northern Trust determines and maintains accurate asset and transaction data and possess the ability to efficiently deliver this information to clients. Increasingly, paper reports are being replaced by online systems that deliver the information electronically.

Northern Trust ensures data accuracy through a number of controls and procedures. An emphasis on automation is supported by straight through processing (STP) where all services across Northern's platform are fully integrated allowing data to flow automatically with minimal manual intervention.

- Trade instructions are subject to dozens of validation and logic checks and are tracked in real time. Cash movements including wires and disbursements are verified through an "Authorized Parties" list to initiate cash movement, a two-tiered approval structure, and various security protocols.
- Northern's Valuation Reporting Group (VR) is responsible for reviewing and reconciling client reporting and acts as the client's dedicated accounting team. VR teams are divided into specialized areas based on client demographic and type and are located in Chicago, London, Bangalore, and Singapore.
- In the event of an entry error, the appropriate entry is amended. Depending on the client's preference the entry may be amended through a current period adjustment of a prior period entry or by correcting a prior period.

Data Direct is a unique value added tool that allows clients to establish a data feed from Northern Trust's accounting and reporting platform to the client's desktop accessed through Excel so analytics can be updated with the push of a button through an Excel add-in.

Northern Trust's retention policies:

- Transactions – Available online for 24 Months
- Month-End Holdings – Available online for 24 Months
- Daily Holdings – Available online for 3 Months
- Periodic Data (Transactions, Holdings, etc.) – Accessible to Northern Trust staff per client requests.

We find that Northern's reporting platform Passport® and general accounting and performance reports are simple for users to read and use. Northern's accounting processes and statements include the features expected of a competitive custodian. The Time-frames after the close of the period for availability of audited and unaudited results are comparable.

Process - Derivatives

Northern Trust's operations team, Derivative Operations, is housed within the operations department and includes over 308 specialists. Processing exchange traded and over the counter derivatives are part of the standard custody service as well as collateral clearing and safekeeping. Northern Trust also offers a fully outsourced derivatives servicing model where Northern Trust handles most operational aspects of managing derivatives that is traditionally the responsibility of the investment manager. This service offering is typically utilized by an investment manager that does not have this expertise in house or an institutional investment plan that is managing derivatives in-house.

- Northern Trust utilizes trade capture services provided by GMI for exchange traded derivatives (ETD). GMI, owned by SunGard, supports futures, options on futures, and listed equity options processing. Automated trade feeds are also available from major brokers including Citigroup, Barclays, Goldman Sachs, and Credit Suisse. Northern provides trade capture services for over the counter (OTC) derivatives through Summit, an industry standard OTC trade capture portal which is managed in-house. Summit supports trade capture via fax instructions, .CSV, .XML, FTP, and FpML (Financial Product Markup Language).
- Confirmation and matching services are provided by Markit Trade Manager and supports connectivity to industry leading matching utilities including Misys, DSMatch, and MarkitWire. Northern uses Markit PortRec to support daily reconciliation on client and counterpart data which is pre-programed to follow ISDA guidelines.
- Northern's outsourced lifecycle management service includes the calculation of rate resets, cash forecasting, event notifications, corporate action monitoring, and 5-day cash ladder reporting. Northern's custody service for lifecycle processing includes reset and coupon processing, collateral movements, and margin movements.
- Independent valuation is supported by three independent pricing vendors including Markit covering credit derivatives and credit default swaps, Numerix covering options and interest rate swaps, and Super Derivatives covering FX.
- Collateral management services are provided by Lombard Risk's Colline™ Collateral Engine and include managing collateral in accordance with legal agreements, calculating exposure and initiating collateral calls, verifying counterparty collateral demand, and recording and reconciling collateral positions. Clients are able to access real-time reporting through Passport®, monitor corporate actions and interest payments on assets delivered as collateral, and offer bi- and tri-party safekeeping for client or agent and the OTC counterparty.

Process – Private Assets

Effective monitoring and reporting of private asset investments, which are typically structured as limited partnerships, requires specialized skill sets and systems.

Northern Trust's private asset reporting capabilities meet all the desired needs of the standard client and do an adequate job of pulling data from The Burgiss Group into reports that are easy to use and customized through the Northern Trust website. Benchmark and universe capabilities are driven by Burgiss and fall in line with the other custodians. While reports are customizable through Passport®, Northern lacks an interactive interface to allow users to create and update reports without having to run them; Data Direct only partially makes up for this. As is evident from their Data Direct tool, Northern Trust places a premium on user-friendly applications also seen through their cash flow modeling/pacing tool; which is both easy to use and complex in its offerings.

- Processing and control groups are assigned by general partner. Northern Trust Alternative Asset specialists work through the Private Equity Desktop (PED), an internal centralized platform for alternative asset data, to gather, process, and audit transaction and valuation activity through statements received via e-mail and direct mailing.
- Full history of documents can be accessed through Northern's Document File Cabinet via Passport®. Files are easily accessible and organized by partnership name and document type (capital calls, distributions, etc.).
- Private Outlook is an additional tool used for cash flow and allocation modeling that utilizes Monte Carlo simulation. The models allow clients to create custom scenarios to analyze cash flow needs for capital calls over one and five-year periods and model future allocation levels.
- The standard performance calculation method is IRR (internal rates of return). Adjusted valuations are created using the most recent statements received and any activity that has occurred. Given that many alternative asset results are reported on a lag, a second view of performance data is available and does not affect the initial audit accounting cut-off.

Process – Global Custody

Global custody services involve the execution and coordination of investment-related activities for non-U.S. assets. Global custody is a much more complex service than domestic custody. Not only are transactions and income collections more difficult, but custodians have the additional tasks of tax reclaim processing and multi-currency reporting.

Northern's global custody system operates on a single platform that allows the handling of transactions and pricing to flow through to client reporting and analytic tools. Northern's sub-custodian network covers 102 markets and offers settlement capabilities in developed and emerging markets. As of December 31, 2012, Northern has 698 client domiciled outside of the U.S. and approximately $2.1 trillion in assets under custody. Northern has dedicated staff members in the global custody group that follow, prepare, submit, and credit tax reclamations.

When a custody bank is not a direct participant in a given market, there is a need to partner with a local agent. The local agent is authorized to transact in the given market, and this is a more efficient global custody model relative to establishing custody capabilities in every market. Northern has a strong network of sub-custodians covering 102 global securities markets. Reconciliation between sub-custodians and depositories is an automated process that occurs on a daily basis through SmartStream's – TLM, a reconciliation system integrated into Northern's processing platform. Northern conducts continuous monitoring of its sub-custodian network and is managed by the Sub-Custodian Network Management Team (SCNM). In addition to monitoring, SCNM conducts various formal reviews on a semi-annual and annual basis.

Process – Compliance Monitoring

Compliance monitoring is a useful tool offered by most of the industry's leading custodians that allows clients to monitor the investment program's compliance with their unique and specific investment guidelines.

Northern Trust offers its proprietary compliance monitoring system, Northern Trust Compliance Analyst®. Compliance Analyst® is an automated tool that monitors a number of investment policy guidelines. Northern was the first custodial bank in the industry to offer a compliance monitoring application when it was introduced in 1996.

Clients are able to customize compliance parameters specific to their unique guidelines and can adjust the types of exposures monitored as well monitoring frequency. Risk monitoring is available at all security levels, asset classes, and portfolios on a daily basis.

Northern offers three levels of service: Core, Enhanced, and Premium

- The Core offering allows clients to manage Compliance Analyst® through Passport®. The portfolio accounting data is reviewed on a daily basis and the client is notified of any breach of compliance with an Exception Report sent via e-mail consisting of detailed information regarding the breach.
- Northern's Enhanced service has Northern Trust manage Compliance Analyst® on the client's behalf. The review and analysis of Exception Reports lies with the client. An added feature, ComplianceRADAR (RADAR) is a compliance tracking tool that assists client's to resolve potential guideline breaches more efficiently through a user-friendly dashboard.
- The Premium service allows clients to outsource the entire compliance monitoring responsibility to Northern Trust. Clients are assigned a compliance monitoring consultant to help determine necessary services and assist in the development of a compliance monitoring program. The premium service is offered on a daily, weekly, or monthly basis.

Process – Risk Reporting

Northern Trust provides risk reporting services through MSCI BarraOne made available through Passport® and is integrated directly with the accounting system. MSCI BarraOne utilizes a Fundamental Multi-Factor Model to provide detailed risk decomposition and forecasting abilities on a multi-asset level for ex-ante risk analysis. While available risk reports range from Value-at-Risk (VaR), stress tests, portfolio decomposition, portfolio optimization, and "What-if" scenarios, not all can be run by the client. For specific reports, clients must describe what they are looking for and request their Northern contact to run the analysis.

Private Assets are modelled using public market proxies through Burgiss and can be incorporated into the total fund risk analysis. Private Equity can be broken out by sector and country/regional exposure and Real Estate by leverage type and sector/geography. Hedge Funds can also be incorporated with three approaches for analysis including the use of holdings when available, the Barra Hedge Fund module for return regressions and factor exposures, and market index proxies.

Process – Performance Measurement/Reporting

Northern Trust has a robust performance reporting platform that provides support across all asset classes and is comparable to other custodians. Northern's internally developed performance measurement and reporting system is offered through the Investment Risk & Analytical Services (IRAS) area and is supported by 280 investment professionals. Reports and analytics are accessed via Passport® and is part of the single multi-currency engine.

- Northern Trust has 690 institutional clients subscribed to IRAS representing more than $3.6 trillion in assets.
- Each client is assigned a dedicated Senior Consultant and Senior Analyst. Senior Consultants generally have over 15 years of relevant investment experience and are supported by the Product Development, Comprehensive Economic Research, Investment Research, and Accounting Teams. In the event a potential data issue is identified, analyst will contact their accounting counterpart directly regarding the query.
- Performance data is directly linked to the accounting database. Rates of return and other performance measures are calculated under guidelines

provided by the CFA Institute, GIPS, and BAI standards on a daily, monthly, and cumulative basis. For monthly performance, preliminary returns are available one business day after month end and finalized data is available two to four days after accounting is finalized.

- Northern also collaborates with Mellon Analytical services and provides access to TUCS, Informa's PSN manager database and Venture Economic's Private Equity Universe. Universe data is available two weeks following quarter-end.
- Returns are reconciled prior to the production of periodic performance reports using various automated on-line tools and exception-based reports. Given that the performance and accounting areas utilize a single database provides additional assurance of accuracy. Performance can also be calculated gross and net of fees.
- Northern Trust currently maintains over 10,000 worldwide indices utilizing Rimes Technologies, a third party index aggregator, as a primary source. There is also flexibility to add additional indices.
- Performance including returns, market values, and cash flows can be backloaded from the inception at the account or composite levels.

Risk Management

Northern Trust employs a number of security measures in order to protect client account information. The Corporate Data Security unit is a dedicated department separate from Northern's operating, business, or systems organization that oversees security issues and requests regarding client access.

- Authorized members grant access to users for specific programs and reports.
- Corporate Data Security authorizes and sets up all users to access approved programs and reports based on user roles.
- All requests for access and approvals are tracked via Identity Manager which provides audit trails for all data maintained.
- Users are automatically logged off of programs after no activity for a specified time frame.

Also, regulators conduct stress testing on Northern Trust periodically as part of their regulatory oversight. Such testing evaluates the bank's capital level to see if Northern Trust has enough capital to withstand unfavorable economic scenarios. These tests are beneficial as they allow Northern Trust to take preventive action if needed based on the results of the tests.

Operations

Northern Trust has a dedicated operations unit, Operations & Technology (O&T). Northern has appropriate disaster recovery and contingency plans. Northern's business continuity philosophy emphasizes disaster prevention, mitigation, and recovery. The disaster recovery plans include continuous monitoring of critical support systems, two Corporate Data Centers located in separate geographical locations, fire protection systems in all data facilities, and regularly scheduled site hazard analysis.

Northern's external accounting firm runs an annual SSAE16 exam on the operating controls and procedures in place. Northern recently received an unqualified opinion from their independent auditor, KPMG, regarding the most recent SOC 1 Report with no material deficiencies noted.

	Northern's organizational structure is clear and each role under senior management is distinct and does not generally overlap. Northern's consultant relations team is always very willing to host onsite visits as well as visit HEK's offices whenever Northern Trust makes any major enhancements to their technology or umbrella of custody services.
Terms & Conditions / Reporting	Northern Trust's custody fee structure and invoicing layout is simple and easy to follow. Custody fees are reasonable when compared to their peers.

Ratings Explanation

Hewitt EnnisKnupp (HEK) has developed a ratings framework whereby investment products are assigned an overall rating of "buy", "hold", or "sell" based on the following factors: business, staff, process, risk, operations, performance and terms and conditions. HEK has adapted this framework to the rating of securities lending agents. Each factor was assigned a rating of 1 to 4, where:

1 = Weak
2 = Average
3 = Above Average
4 = Strong

An overall rating was then derived from the individual ratings. We do not assign a fixed weight to each criterion to establish the overall rating; instead we consider each case individually. The overall rating score can be interpreted as follows:

Buy	=	We recommend clients engage in securities lending with this agent.
Hold	=	We recommend that clients continue to engage in securities lending with this agent; however, we do not actively recommend this agent to new clients.
Sell	=	We recommend termination of the securities lending agent.
In Review	=	The rating is under review as we evaluate factors that may cause us to change the current rating.

The comments and assertions reflect our views of the specific securities lending agent and our opinion of its strengths and weaknesses.

Disclaimer

This document has been produced by Aon plc. Nothing in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. It should not be taken as financial advice and action should not be taken as a result of this document alone. Consultants will be pleased to answer questions on its contents but cannot give individual financial advice. Individuals are recommended to seek independent financial advice in respect of their own personal circumstances.

Aon plc
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London
EC2M 4PL

Callan

March 10, 2014

North Dakota
Retirement & Investment Office

Trust and Custody Services

Trust/Custody Consulting Team

Virgilio "Bo" Abesamis III

- Executive Vice President
- Manager of the Master Trust, Global Custody, and Securities Lending Group
- 25th year with Callan
- Callan Shareholder
- B.S., Ateneo de Manila, Philippines
- M.B.A., University of San Francisco

Mark Kinoshita

- Vice President
- Trust, Custody and Securities Lending
- 1st year with Callan
- 20th year in industry
- B.A., University of California, Santa Barbara

An Overview of Callan Custody Consulting Group

Trust, Custody, and Securities Lending Group Experience

- **Dedicated Expertise**
- **Depth of Projects**
- **Client Engagements**
- **Process of Collaboration**
- **Solutions Driven**

Over the past five years, the Trust, Custody, Securities Lending, and Transition Management Group completed **151** distinct project engagements:

Trust, Custody and Securities Lending Group Clients	Total Number of Clients Advised	Total Assets Advised ($ billions)	Average Size ($ billions)
2008	36	210	5.8
2009	51	432	8.5
2010	22	160	7.3
2011	19	295	15.5
2012	23	190	8.3

➢ ***Callan is prepared to draw upon our Database of Completed Searches and Negotiated Fees, Active Monitoring of Providers, and Bottom-Up Product Knowledge of the custodian banks, securities lending agents and other providers to support Kamehameha Schools in achieving your objectives.***

Experience

Public Funds

- Florida Pre-Paid Tuition Program
- State of Georgia Division of Investment Services
- State Universities Retirement System of Illinois
- Arkansas Public Employees' Retirement System
- City of New York Retirement Systems
- City of Wichita Retirement Systems
- State of Wisconsin Investment Board

"Clients, Our Single Greatest Source of our Collective Wisdom"

Corporate ERISA

- American Airlines Plans (DB and DC Plans)
- BP North America (DB and DC Plans)
- Deluxe Corporation (DC Plan)
- Hewlett-Packard Company (DB, DC and Group Trusts)
- International Paper Company (DB and DC Plans)
- Kaiser Permanente (DB and DC Plans)
- CenturyLink (DB and DC Plans)

Endowments and Foundations

- Alaska Permanent Fund Corporation
- Caltech Endowment
- Duke University Endowment
- University of Notre Dame Endowment
- The Ohio State University
- Stanford University Endowment

Types of Projects and Consulting Work

- Full Due Diligence Search and Review
  - Best Practice
  - Core and Ancillary Services
  - Operational Functionality and Enhancements
  - Tighten Operations' Back-office and Risk Management
  - Competitive Bidding through a Fair and Transparent Process
  - Understand Fees and Costs
- Due Diligence Assistance and/or Shadowing
  - Supplement Client-led Search Process
  - Provide Guidance and Education
  - Offer added layer of Objectivity and Disciplined Process
  - Assist in Negotiations
- Benchmarking Review
  - Best Practice and Industry Standards
  - Review of Contracted Services vs. Services Delivered
  - Peer Comparison on Services and Fees
  - Documentation
- Fee Analysis
  - Understand Fees and Costs
  - Review Fee Schedule and Invoices
  - Identify both Explicit and Implicit Costs
  - Transparency

Core and Ancillary Services

Core Services

- Valuation and Pricing of Assets
- Income Collection and Corporate Actions
- Trade Processing - T+1 and Straight Through Processing
- Back to Basics - "Book of Record"/ Unitization Accounting
- Reporting and Performance
- Benefit Payments and Administration
- On-Line and Internet - 24 hrs.
- Compliance Monitoring
- Class Action, Corporate Governance and Proxy
- Complex Investment Managers and Asset Classes, including support of In-house Investment Functions

Ancillary Services

- Securities Lending
- Support Third Party Securities Lending
- Cash Management / STIFs
- FX and Treasury
- Investment Management (Index Products)
- Multinational Pooling
- TBO (Total Back-Office Outsourcing – Mutual Fund Daily Valuation, Transfer Agency, Shareholder Reporting, etc.)
- Plan Accounting, Unitization, and Fund/Sub-Fund Accounting
- Brokerage Services – Transition Management
- Risk Management Tools

Implementation Methodology:

Work Plan for Operations Assessment and Best Practice Review

Work Plan

Information Gathering Phase (First 1 to 2 months of Process)	Description	Estimated Completion
Information Gathering and Review of Documents	Inventory Check of Services, Plan Structure and Data/Document Gathering regarding North Dakota State Investment Board Pension Trust and Insurance Trust requirements.	2 weeks to complete
Operational Assessment	Visit North Dakota State Investment Board Pension Trust and Insurance Trust to Interview and Discuss Requirements, Overall Custody Needs and Ancillary Services Support with investment and operations staff. Discuss the current custodian's performance, service deliverables and staff's expectations. We also like to see how the client employs the online tools provided by the custodian. By understanding your expectations, we can formulate a solution and identify where operational efficiencies can best be deployed.	On-site Assessment - 2 days to complete.
Education Session	Best practice and custody industry discussion with the North Dakota State Investment Board staff. Learn the level of services and products provided by "institutional" custodian banks for Plans similar to the North Dakota State Investment Board Trusts. Fast track education about industry trends, benchmarking and best practice initiatives.	½ to 1 day to complete
Benchmarking	After the operational assessment, Callan will prepare a Benchmarking Study comparing the North Dakota State Investment Board Trusts with other large institutional investors, including endowments, foundations, public and sovereign wealth funds. The benchmarking report incorporates information from the Database of Completed Searches and Database of Custody and Ancillary Services Fees. The comparison would be with similar clients in terms of asset size, investment structure, and scope of work	Client Profile – Product and Service Requirements – 1 to 2 weeks to complete.
Investment Manager Feedback	Gather investment manager feedback regarding custody needs – generic and distinct requirements. A survey of the client's investment managers is conducted to obtain an important perspective on the valuation and handling of transactions. Items such as trade processing, corporate actions, pricing, valuation and impact of securities lending are reviewed and then scored by the client's current investment managers. We compile the survey and then rank the responses, essentially building a mini-universe for comparative purposes.	2 weeks to complete

Work Plan

Evaluation and Implementation Phase (Last 1 to 2 months of Process)	Description	Estimated Completion
Discuss Findings	Callan will present findings and assist North Dakota State Investment Board in reviewing current structure and processes that can be automated or streamlined by relying more heavily on the capabilities of the custodian ultimately reducing risk.	1 to 2 days to complete
Identify Structural Areas and Processes to Address	Callan is prepared to assist North Dakota State Investment Board in identifying and prioritizing specific structural considerations and processes that could be improved by utilizing the services of the custodian.	2 to 3 weeks to complete
Facilitate Meeting with Provider (if necessary)	Callan will participate in discussions with North Dakota State Investment Board staff and the custodian to identify additional needs and service requirements where appropriate.	2 weeks to complete

Proposal Recap

Conclusion

- Why Callan?
  - Dedicated Trust, Custody, and Securities Lending Group
  - Depth of Experience
  - Process of Collaboration
  - Understands Needs of Large Institutional Investors, Including Public and Sovereign Wealth Funds, Endowments and Foundations.
  - Industry Knowledge and Industry Voice
  - Due Diligence Process

- We Really Do Want Your Business and are Eager to Serve North Dakota State Investment Board.

Appendix

Consulting Team Biographies

Virgilio "Bo" Abesamis III, Executive Vice President. Bo is the Manager of the Master Trust, Global Custody, and Securities Lending Group. Bo joined Callan Associates in 1987 and is a shareholder of the firm. Initially, Bo worked in the Capital Markets Research Group with responsibilities involving asset/liability modeling, manager structure, benchmark and database reviews, style analysis, and research.

Bo previously managed the Specialty Performance Measurement Group at Callan Associates with an emphasis on analytics involving non-traditional asset classes, namely international, alternative investments, and real estate. He also assisted in the development of Callan's International Consulting Services Group and Defined Contribution Consulting Services Group.

Bo earned a B.S. degree in Accounting and Finance from Ateneo de Manila, Philippines, and an M.B.A. with a double major in Finance and International Business from the University of San Francisco.

Mark Kinoshita, is a Vice President in Callan's Trust, Custody and Securities Lending group. His responsibilities include the intensive evaluation of global master custodians, conducting on-site due diligence visits, developing optimal operations structures and the coordination of special projects.

Mark has over 20 years of experience in the asset servicing industry having worked in such areas as income collection, settlement operations, client reporting, client systems consulting, project management, product development, relationship management and business development. This knowledge provides him with a broad and unique industry perspective enabling him to understand client needs and identify solutions though a consultative approach. Mark has experience working with all constituent levels at public funds, corporate pension plans, Taft-Hartley pension plans, endowments, foundations, corporate treasury, banks, mutual funds and insurance companies. Prior to joining Callan, Mark previously worked as a Business Development Officer at Comerica Bank, and at the asset servicing divisions of Bank of New York and Bank of America.

Mark earned a BA in Political Science from the University of California, Santa Barbara.

Disclaimer

This report is for informational purposes only and should not be construed as legal or tax advice on any matter. Any decision you make on the basis of this content is your sole responsibility. You should consult with legal and tax advisers before applying any of this information to your particular situation.

This report may consist of statements of opinion, which are made as of the date they are expressed and are not statements of fact.

Reference to or inclusion in this report of any product, service or entity should not be construed as a recommendation, approval, affiliation or endorsement of such product, service or entity by Callan.

Past performance is no guarantee of future results.

The statements made herein may include forward-looking statements regarding future results. The forward-looking statements herein: (i) are best estimations consistent with the information available as of the date hereof and (ii) involve known and unknown risks and uncertainties such that actual results may differ materially from these statements. There is no obligation to update or alter any forward-looking statement, whether as a result of new information, future events or otherwise. Undue reliance should not be placed on forward-looking statements.

Securities Lending Background, Development & Next Steps

Background: In 2008, many securities lending participants incurred **investment losses** as a result of **"risky collateral"** being included in various securities lending programs. Despite many lending agents providing an indemnity to clients for **borrower risk**, many participants incurred investment losses due to **"risky collateral"**. Previously, many participants believed **borrower risk** (or **counterparty risk**) was the biggest risk in securities lending. Post 2008, securities lending participants now realize that collateral quality is equally (or more) important as **borrower risk**.

Market Developments: Many lending agents have created enhanced collateral investment strategies where the lending agents have became comfortable providing indemnification for both **investment risk** and **borrower risk**.

Enhanced Collateral Investment Strategies: An account can be structured such that all investments would be on an overnight basis and consist of only US Treasury backed Repurchase Agreements (i.e. the Repurchase Agreements would be over-collateralized by US Treasuries) at a minimum of 102% of the cash value. All cash collateral would be reinvested daily, thereby ensuring that the over-collateralization requirement is refreshed each business day.

Proposal: Northern Trust is willing to propose this strategy based upon a US Treasury backed overnight repo Custom Cash Collateral Account. Based upon successful negotiation of a Securities Lending Authorization Agreement and Cash Collateral Investment Guidelines, Northern Trust would provide indemnification of the repurchase agreements in the Custom Cash Collateral Account.

Risk Statement: Northern Trust is unable to make a definitive statement that a loss would never occur. However, under the structure described above, it would likely take a default of the US Government, a default of the repo counter-party and a default of Northern Trust in order to generate a loss.

Next Steps: In connection with our custody review, RIO will work with our investment consultant to confirm the structure, risks and estimated cost savings of the proposed Enhanced Collateral Investment Strategy. The cost savings are preliminarily estimated at approximately $900,000 per year.

NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

Staffing Update

March 27, 2014

During the past four months, the RIO team has been successful in filling three vacant positions, promoting from within to eliminate a future vacancy in Information Technology and posting for the Audit Supervisor and IT Coordinator positions. We have also revised our organizational chart to more accurately reflect observed reporting lines from a functional perspective.

The RIO Executive Team understands the importance of proper staffing levels as the success of the Agency is critically dependent on the interaction and effectiveness of our outstanding staff.

- Gary Vetter announced his retirement as RIO's Information Technology Supervisor. Mr. Vetter's last day will be March 31, 2014.

- Rich Nagel, RIO's current IT Coordinator, will be promoted to RIO's Information Technology Supervisor effective April 1, 2014.

- RIO's IT Coordinator position, which will be vacant as a result of Rich's promotion, was posted on February 20, and advertised on February 23 and March 2. We interviewed five candidates for this position on March 20.

- RIO's Audit Supervisor position was posted on December 31, 2013. To expand the applicant pool, the position was reposted and re-advertised in March 2014. Application closing date was March 18.

- The Investment Analyst position will be posted once an organizational review of investment and fiscal division duties is completed.

- Annual performance reviews will commence in April and are expected to be discussed with staff in May prior to being finalized in June.

ND STATE INVESTMENT BOARD
AUDIT COMMITTEE MEETING

Friday, February 28, 2014 - 1:00 p.m.
Peace Garden Room - State Capitol, Bismarck, ND

AGENDA

1. Call to Order and Approval of Agenda - Chair (committee action)

2. Approval of November 22, 2013 Minutes - Chair (committee action)

3. 2013-14 Audit Activities Progress Report - Dottie Thorsen and Fay Kopp (committee action)

4. GASB #67 and #68 Implementation Planning - Fay Kopp (discussion only)

5. Audit Supervisor Vacancy Update - Fay Kopp (discussion only)

6. RIO Organizational Update - Dave Hunter (discussion only)

7. Other Business
   Next SIB Audit Committee meeting - May 23, 2014

8. Adjournment

Any individual requiring an auxiliary aid or service should contact the Retirement and Investment Office at (701) 328-9885 at least three (3) days prior to the scheduled meeting.

STATE INVESTMENT BOARD
AUDIT COMMITTEE MEETING
MINUTES OF THE
NOVEMBER 22, 2013, MEETING

COMMITTEE MEMBERS PRESENT:	Rebecca Dorwart, Chair Lonny Mertz, Vice Chair Mike Gessner, TFFR Board/Liaison to the SIB Mike Sandal, PERS Board Cindy Ternes, Workforce Safety & Insurance
STAFF PRESENT:	Bonnie Heit, Assistant to the Audit Committee Fay Kopp, Interim Executive Director Shelly Schumacher, Retirement Program Manager Dottie Thorsen, Internal Auditor Susan Walcker, Investment Accountant
OTHERS:	Jason Ostroski, CliftonLarsonAllen

CALL TO ORDER:

Ms. Dorwart called the State Investment Board (SIB) Audit Committee meeting to order at 1:00 p.m., on Friday, November 22, 2013, at the State Capitol, Peace Garden Room, Bismarck, ND.

A quorum was present for the purpose of conducting business.

AGENDA:

The Audit Committee considered the November 22, 2013, agenda.

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MS. TERNES AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE NOVEMBER 22, 2013, MEETING.

AYES: MR. SANDAL, MS. TERNES, MR. MERTZ, MR. GESSNER, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

MINUTES:

The Audit Committee considered the minutes from the September 27, 2013, meeting.

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MR. MERTZ AND CARRIED ON A VOICE VOTE TO ACCEPT THE SEPTEMBER 27, 2013, MINUTES AS WRITTEN.

AYES: MR. GESSNER, MR. SANDAL, MS. TERNES, MR. MERTZ, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

FINANCIAL AUDIT REPORT:

Mr. Jason Ostroski, CliftonLarsonAllen, reviewed the audit results of the Retirement and Investment Office's (RIO) financial statements for the fiscal year ended June 30, 2013. Mr. Ostroski also reported CliftonLarsonAllen has issued an unmodified, clean, opinion.

Mr. Ostroski also reviewed the new accounting statements the Governmental Accounting Standards Board (GASB) recently approved. GASB 67, Financial Reporting for Pension plans, replaces GASB 25. It provides for accounting with respect to the TFFR plan, effective fiscal year July 1, 2013, to June 30, 2014. GASB 68, Accounting and Financial Reporting for Pensions, replaces GASB 27. It provides for the financial reporting by employers/school districts with respect to TFFR, effective fiscal year July 1, 2014, to June 30, 2015.

IT WAS MOVED BY MS. TERNES AND SECONDED BY MR. SANDAL AND CARRIED BY A VOICE VOTE TO ACCEPT CLIFTONLARSONALLEN'S AUDIT REPORT OF THE FINANCIAL STATEMENTS FOR THE RETIREMENT AND INVESTMENT OFFICE FOR THE FISCAL YEAR ENDED JUNE 30, 2013.

AYES: MS. TERNES, MR. MERTZ, MR. SANDAL, MR. GESSNER, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

The Audit Committee thanked staff for their hard work and congratulated them for all of their efforts working with CliftonLarsonAllen in putting together an excellent audit report.

AUDIT ACTIVITIES REPORT:

Ms. Kopp and Ms. Thorsen reviewed internal audit activities for the July 1, 2013 - September 30, 2013 period.

With the retirement of the Internal Audit Supervisor, current plans are to complete 24 school district audits and four not in compliance reviews. As of November 15, 2013, eight audits were completed, three audits are in progress, and one not in compliance review is in progress.

The TFFR File Maintenance Audit was completed and changes made to TFFR member account data by RIO employees was tested. No exceptions were noted.

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE INTERNAL AUDIT ACTIVITIES REPORT FOR THE PERIOD OF JULY 1, 2013 - SEPTEMBER 30, 2013.

AYES: MR. GESSNER, MR. MERTZ, MR. SANDAL, MS. TERNES, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

RIO STAFF VACANCIES:

Mr. Sandal and Ms. Kopp updated the Audit Committee on RIO staff vacancies.

Mr. David Hunter will begin his duties as Executive Director/Chief Investment Officer on December 2, 2013.

Mr. Cody Schmidt will begin his duties as Compliance Officer on December 9, 2013.

The Fiscal and Investment Officer and Investment Analyst positions will be posted once an organizational review of investment and fiscal division duties are reviewed with the new ED/CIO.

Gary Vetter, Supervisor of Information Services, announced his retirement on November 4, 2013. His last day of employment will be March 31, 2014.

Ms. Kopp will be reviewing and discussing the Supervisor of Internal Audit position with the Audit Committee at their November 22, 2013, meeting.

INTERNAL AUDIT SUPERVISOR POSITION:

Ms. Kopp reviewed with the Audit Committee the following documents as they relate to RIO's Audit Supervisor of Internal Audit position; SIB Governance Policy/Standing Committees/B-6, the Audit Committee charter as it exists today, the current job description, agency organization chart, and office administrative hiring policy. The Audit Committee and Ms. Kopp also discussed the audit functions within the agency and the audit reporting structure.

Ms. Kopp recommended filling the Audit Supervisor position in substantially the same form the format as it exists today. Once the position has been filled, the new Audit Supervisor of Internal Audit, RIO executive management, and the Audit Committee will work together to review the current audit function within the agency, audit reporting structure, and audit programs and procedures in order to identify how to best structure RIO's audit program for the future.

The Audit Committee also discussed having at least one member from the Audit Committee participate in the hiring or selection process. After discussion,

IT WAS MOVED BY MS. TERNES AND SECONDED BY MR. MERTZ AND CARRIED BY A VOICE VOTE TO HAVE AT LEAST ONE MEMBER FROM THE AUDIT COMMITTEE ACTIVELY INVOLVED WITH THE ED/CIO OF RIO IN THE HIRING OF THE AUDIT SUPERVISOR OF INTERNAL AUDIT.

AYES: MR. SANDAL, MS. TERNES, MR. MERTZ, MR. GESSNER, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

Ms. Dorwart, Chair, volunteered to be involved in the hiring of the Audit Supervisor position.

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. GESSNER AND CARRIED BY A VOICE VOTE TO AUTHORIZE STAFF TO MOVE FORWARD IMMEDIATELY WITH FILLING THE AUDIT SUPERVISOR OF INTERNAL AUDIT POSITION FOR RIO.

AYES: MR. GESSNER, MR. SANDAL, MS. TERNES, MR. MERTZ, AND MS. DORWART
NAYS: NONE
MOTION CARRIED

OTHER:

The next Audit Committee meeting is scheduled for February 28, 2014, at 1:00 p.m. at the State Capitol, Peace Garden Room.

ADJOURNMENT:

With no further business to come before the Audit Committee, Ms. Dorwart adjourned the meeting at 2:52 p.m.

Respectfully Submitted:

Rebecca Dorwart

Ms. Rebecca Dorwart, Chair
SIB Audit Committee

Bonnie Heit

Bonnie Heit
Assistant to the Audit Committee

RESPONSE	FUND	BRD ED	RFP	FOREIGN	DOM	FIRM	ATTCH
1	MERS of MI	No	No	Yes	Yes	Spector Roseman	no
2	MA Pension	?					no
(part of 2)	CO PERA	?					no
3	VRS	yes(staff)	Yes	?	Yes	Bernstein Litowitz Kaplan Fox Labaton Sucharow	yes
4	Kansas PERS	yes(in house legal)	yes	?	yes	Girard Gibbs and DeBartolomeo	yes
5	Denver ERP	yes(in-house & ext legal)	yes	yes	yes	Barrack, Rodos and Bacine Grant & Eisenhofer Hagens, Berman, Sobol, Shapiro Robins, Geller, Rudman & Dowd	yes
6	West Virginia Inv Brd	?	no	yes	yes	Robins, Geller, Rudman & Dowd Spector Roseman	no
7	St. Louis	?	yes	?	yes	Berman DeValerio Saxena White Spector Roseman Grant & Eisenhofer Bernstein, Litowitz, Berger and Grossmann	no
8	Washington AG	?	yes	no	yes	?	yes
9	San Fran ERS	?	yes	yes	yes	? Not yet available	yes
10	Chicago Teachers'	?	yes	yes/or will	yes	Spector Roseman 3 others? Rec 2 for foreign Grant & Eisenhofer Bernstein, Litowitz, Berger and Grossmann	yes
11	Utah Ret System	yes, staff/ in-house legal	no	?	yes	Spector Roseman also adding firms	no
12	SamCERA	?	yes	soon	yes	Grant & Eisenhofer	yes
13	Ill Mun Ret Fund	?	yes	?	yes	Berman DeValerio Labaton Sucharow	yes
14	LA County ERA	yes, staff/ in-house legal	yes	yes	yes	Dom Mont: Bernstein, Litowitz, Berger and Grossmann Berman DeValerio Grant & Eisenhofer For Mont: Spector Roseman Labaton Sucharow Kessler Topaz	yes
15	Ill. Univ System (obtained by CIO not NAPPA listserve)	?	yes	?	yes	Berman DeValerio Robins, Geller, Rudman & Dowd Labaton Sucharow	yes

"Callan College"

2014 Dates

- Introductory "Callan College" sessions
  - April 23-24, 2014 in San Francisco
  - October 28-29, 2014 in San Francisco
- Standard "Callan College" session
  - April 15-16, 2014 in Atlanta
  - July 15-16, 2014 in Chicago

"Callan College"

Introductory Session

- This one and one half day session is designed for individuals who have less than two years' experience with institutional asset management oversight and/or support responsibilities. The session will familiarize fund sponsor trustees, staff, and asset management advisors with basic investment theory, terminology, and practices.
- Participants in the introductory session will gain a basic understanding of the different types of institutional funds, including a description of their objectives and investment program structures. The session includes:
  - A description of the different parties involved in the investment management process, including their roles and responsibilities
  - A brief outline of the types and characteristics of different Plans (e.g. defined benefit, defined contribution, endowments, foundations, operating funds)
  - An introduction to fiduciary issues as they pertain to Fund management and oversight
  - An overview of capital market theory, characteristics of various asset classes, and the processes by which fiduciaries implement their investment sessions

"Callan College"

Standard Session

- This is a two day session designed for individuals with more than two years' experience with institutional asset management oversight and/or support responsibilities. The session will provide attendees with a thorough overview of prudent investment practices for both defined benefit and defined contribution funds. We cover the key concepts needed to successfully meet a fund's investment objectives.

- The course work addresses the primary components of the investment management process:
  - The Role of the Fiduciary
  - Capital Market Theory
  - Asset Allocation
  - Manager Structure
  - Investment Policy Statements
  - Manager Search
  - Performance Measurement