

INVESTMENT PROCUREMENT POLICY

INTRODUCTION

Kentucky law mandates that the Teachers' Retirement System of the State of Kentucky (TRS), through the Board of Trustees, develop and adopt an investment procurement policy (KRS 161.430). The policy must be designed, in consultation with the secretary of the Finance and Administration Cabinet, to follow best practices for investment procurement. This policy functions in concert with other statutes, administrative regulations and guidelines detailing fiduciary and ethical requirements and parameters for investing trust funds. The law shall control if any inconsistency exists between it and this policy.

The procurement procedures in this policy will be implemented consistent with the board's fiduciary duty established by law to procure the managers, goods and services needed to support the investment or management of TRS assets. The board has delegated investment authority to its Investment Committee.

The board also has designated a portion of TRS's funds to be managed externally, including by investment managers specializing in mandates such as equities, bonds, other publicly traded securities, alternative investments, real estate, timberland and/or any other asset type authorized by Kentucky law. Additionally, the board is responsible for the procurement of investment analytical, professional, research and technical services to carry out the investment or management of TRS assets.

Investment procurements will promote the highest level of competition and best value, giving due consideration to factors including, but not limited to, timing (including emergencies), execution, quality, service and price. Whenever TRS is considering an investment procurement, staff – rather than members of the TRS board and Investment Committee – will communicate directly with the principals of the potential vendor to ensure transparency, accountability and compliance with laws and board policies, including those banning payment of fees or commissions to placement agents.

1. Definitions

Alternative investments (alternatives): investments with general partners or managers in assets such as timberland, private equity and infrastructure that are long-term and illiquid in nature.

External investment manager: a vendor selected by an authorized competitive selection process and that is approved by the Investment Committee, subject to ratification by the board, to invest TRS funds in a manner specified by contract.

Highest level of competition and best value: seeking vendors that provide the best performance at the lowest cost (economic efficiency) giving due consideration to factors including, but not limited to, performance improvements (faster, more suitable), timing (including emergencies), execution, quality, trust, reputation, service and price.

Independent: not having conflicts of interest.

Investment consultant: an external firm or individual retained to advise the board and the Investment Committee and assist investment staff in a variety of ways, including as outlined in this policy.

Specialty investment consultant: an external firm or individual retained to advise the board and Investment Committee and assist investment staff in a variety of ways, including recommending general partners or managers for alternative investments.

Investment procurement: all contracts for the investment or management of assets of TRS undertaken subject to fiduciary duty and other legal and ethical standards in accordance with KRS 161.430 (7).

Performance attribution: quantifies the relationship between a portfolio's returns and the active decisions of the portfolio manager.

Placement agents: a third party or firm banned by KRS 161.430 (6) and board policies from receiving fees or commissions incident to an investment by TRS.

Qualitative analysis: a review of a potential vendor that uses unquantifiable information, such as the impact of vendor management expertise, processes and ownership structure on an investment.

Quantitative analysis: economic, business or financial reviews that aim to understand or predict behavior or events through the use of mathematical measurements and calculations, statistical modeling and research.

Quiet Period: a specified timeframe when board members and staff are restricted in communications with potential vendors in designated procurements.

Request For Information (RFI): a document sent to vendors to request specific information or clarification on a service or product.

Request For Proposals (RFP): a document soliciting proposals for a procurement based on the terms listed in the offering document.

Request For Quotations (RFQ): an invitation to suppliers to bid on providing specific products or services.

2. External Manager Selection

External investment managers are to be chosen through a competitive selection process coordinated by TRS investment staff and based upon established criteria. The selection process, which typically involves the assistance of TRS's independent investment consultant, results in a recommendation of a manager. The recommendation will be made to the TRS Investment

Committee for its review and approval, with ratification by the board no later than at its next quarterly meeting.

TRS normally will use an open search process when conducting a manager search. TRS will identify a list of suitable candidates that are appropriate for the mandate. The list of suitable candidates will be developed by TRS staff and/or the independent investment consultant using a broad-based list of potential managers that meet the screening criteria provided by TRS.

TRS also may use a request process such as an RFP, RFI or RFQ when conducting a manager search. The request may be sent directly to known vendors, will be listed on the TRS website and may be advertised through other means such as financial media. Any advertisement will state clearly the mandate for which TRS is seeking a manager. The advertisement also will state certain minimum requirements that a manager must meet.

A written report documenting the particulars of the search process will be given to the Investment Committee with the recommendation of a manager. The report will include matters such as the screening criteria, the number of managers considered, the number of managers interviewed, the number of firms in the candidate pool, any prior TRS history with the manager, references checked and summaries of other qualitative and quantitative analyses.

A. Determination of Screening Criteria

Screening criteria may include, but are not limited to: investment processes; investment products; dollar value and composition of assets under management; historical performance; years of experience; growth of firm; a manager's history with TRS; other client relationships (including experience with large public funds); ownership; the number and depth of investment professionals; research capabilities; structure of the proposed investment (separate account, commingled account, limited partnership, etc.); compliance with standard contractual provisions; compliance with the Chartered Financial Analyst (CFA) Institute Code of Ethics; compliance with Global Investment Performance Standards as administered by the CFA Institute; and reporting consistent with the Institutional Limited Partners Association standards. Other criteria may be added for any search.

B. Preliminary Screening

- 1) TRS staff and/or the investment consultant identify a preliminary list of firms that meet the initial set of screening criteria.
- 2) TRS staff and/or the investment consultant contact each firm on the preliminary list to obtain the most current information and any additional information, as required. Follow-up telephone calls, interviews or on-site visits are made as necessary.
- 3) Based upon the established criteria, staff and/or the investment consultant narrows the preliminary list to a candidate pool.

C. Candidate Pool

- 1) TRS staff and/or the investment consultant conduct a more in-depth interview with each candidate. The interview allows for the interaction with and evaluation of the person or persons who will be investing on behalf of TRS. Interview topics may include:
 - a) Investment process
 - b) Any action or investigation concerning a candidate by a regulatory or civil or criminal enforcement agency
 - c) Any SEC forms, other similar agency reports or prospectuses
 - d) Qualifications of the firm's representatives, including the portfolio management team
 - e) A list of institutional references
 - f) Communication with the firm
 - g) Employee compensation and ownership structure
 - h) Availability of the contact person and portfolio manager to meet with TRS and responsiveness to board and staff concerns
 - i) Validation of performance and the continued management by key individuals who will be responsible for fulfilling assignment
 - j) Accommodation of TRS's priorities
 - k) Experience with large public funds
 - l) Fee discussions
 - m) Conflicts of interest, including the appearance of conflicts of interest. Potential or actual conflicts of interest must be evaluated during due diligence and after engagement under the board's Conflict of Interest and Confidentiality Policy and applicable statutes and regulations. The investment staff will employ reasonable efforts to identify conflicts of interest affecting TRS trustees, employees and managers with respect to all investments.
 - n) Placement agents. Staff will employ reasonable due diligence to ensure that no fees or commissions are paid to a third party or firm banned, either by KRS 161.430 (6) or board policies, from receiving fees or commissions incident to an

investment by TRS.

- 2) Quantitative analyses also are conducted in addition to the qualitative analyses above. This analysis will include performance attribution and risk management.
- 3) Additional due diligence factors may be necessary in selecting general partners or managers for alternatives (such as timberland, private equity and infrastructure) because of the long-term and illiquid nature of these types of investments. The additional factors include particular considerations such as risk management; diversification; and legal and business matters.
 - a) TRS may engage independent specialized consultants to assist in the selection of these managers.
 - b) TRS staff and/or consultants will narrow potential funds to seek best-in-class managers.
 - c) Any new fund offering by an existing manager (also known as a reup) will be evaluated consistent with the process described above (understanding that some of the materials and knowledge for conducting due diligence already may have been obtained based on the prior investment with the manager).
- 4) TRS staff and – if involved in the process – the investment consultant (or, in the case of alternative investments, any engaged specialty investment consultant), will reach a consensus regarding a manager for the final written recommendation to the Investment Committee. Any approval by the Investment Committee is subject to the review by and ratification of the board, the completion of due diligence and the negotiation and execution of a contract.
 - a) It is critical that the terms of the contract accurately reflect the terms and conditions of the authorization. The process may involve highly specialized contract provisions, including investment guidelines, and result in protracted negotiations. Staff may retain outside counsel to assist in the contract process.
 - b) The investment manager must certify that no fees or commissions are paid to a third party or firm banned, either by KRS 161.430 (6) or board policies, from receiving fees or commissions incident to an investment by TRS.

D. An approval of a manager by the Investment Committee is reported to the board no later than at its next quarterly meeting for review and ratification.

3. Procurement of investment analytical, professional, research and technical services

TRS will procure investment-related goods and services through one of the methods below. Nothing in this section shall apply to the procurement of ordinary goods and services that are common to other TRS administrative functions.

- A. Procurement of goods and services costing less than \$5,000 during a fiscal year will be by TRS staff based upon best value comparing known vendors. In comparing vendors, staff will promote the highest level of competition.
- B. Procurement of goods and services costing \$5,000 or more during a fiscal year will be by TRS staff based upon best value comparing known vendors. In comparing vendors, staff will promote the highest level of competition. Staff will collect (if available) three or more bids, quotes or catalog prices from known vendors. The evaluation will be documented by TRS.
- C. TRS may utilize a price contract established by the Commonwealth of Kentucky, the U.S. General Services Administration or U.S. Communities (a national government purchasing cooperative) so long as the vendor sells to TRS at or below the contract price and under the same terms and conditions.
- D. TRS may publish a request, such as an RFP, RFI, RFQ or other invitation, for goods or services. The request may be sent directly to known vendors; will be listed on the TRS website; and may be advertised through other means, such as financial media, as appropriate to promote the highest level of competition. The request will describe the goods or services required, the type of information and data required of each vendor, the relative importance of qualifications and the evaluation factors to be used. After determining the best value of proposals received, TRS may negotiate a contract for goods or services with a vendor. If contract terms cannot be agreed upon with the highest-ranking vendor, negotiations may be conducted with other vendor(s) in the order of ranking as defined by the request. The evaluation of best value will be documented by TRS. The documentation will include specifics of the process used in selecting the vendor. Those specifics may include: price, the number of vendors considered, the number of vendors interviewed, any prior TRS history with the vendor, references checked and summaries of other qualitative and quantitative analyses.
- E. Exceptions to using the methods of procurement above include, but are not limited to: goods and services available only from one uniquely qualified source; advertisements and public notices; and copyrighted computer software. The reason for the exception will be documented by the executive secretary or a deputy executive secretary.

4. Contract Renewal

As applicable, contract renewals, whether they be annual or longer-term agreements, use criteria such as continued need of vendor and/or asset class; level of trust; continuity of ownership, leadership and process; long-term performance; and competitiveness of fees. TRS staff will submit a formal recommendation regarding the renewal of a contract to the Investment Committee for approval. The submission to the committee will include a description of the process used in making the recommendation to renew the contract. Any approval by the Investment Committee is subject to the review by and ratification of the board, the completion of due diligence and the negotiation and execution of a contract.

5. Emergency Procurement

The existence of an emergency may cause an immediate need for managers, goods and/or services that cannot be procured through TRS's normal investment procurement procedures. The determination that an emergency exists is to be made by, and procurement actions approved by, any two of the executive secretary, a deputy executive secretary or the chief investment officer. Thereafter, no later than at the next quarterly meetings of the board and Investment Committee, the emergency and procurement actions incident to the emergency will be reported.

6. Quiet Period

To ensure a competitive and fair procurement, TRS staff, the board and committee members will follow a quiet period with potential vendors during specified timeframes. A quiet period is a specified timeframe when staff, the board and committee members are restricted in communications with potential vendors in designated procurements. Staff assigned to the procurement are not covered by the quiet period and will notify the board, committee and other staff upon initiation of a quiet period and a description of the types of vendors to whom it applies. During quiet periods, covered staff, the board and committee members will not communicate with potential vendors or with an existing vendor on matters pertaining to the procurement, except during board or committee meetings.

A quiet period will cease when the approval of a vendor has been ratified by the board, or if the search process or quiet period are otherwise ended.

7. Other Laws and Policies that Comprise TRS Investment Procurement Policy

This policy is to be implemented in conjunction and accordance with the laws and other policies that, cumulatively, establish the comprehensive TRS Investment Procurement Policy under which all TRS investment procurements are made. These laws and other policies are as follows, but are not limited to:

- A. Executive Branch Code of Ethics (KRS 11A);
- B. Board as fiduciary (KRS 161.420);
- C. Pension Fund investment requirements (KRS 161.430 and 102 KAR 1:175);
- D. TRS conflict of interest prohibitions (KRS 161.460);
- E. TRS confidentiality requirement (KRS 161.585);
- F. Insurance Fund investment requirements (KRS 161.677 and 102 KAR 1:178); and
- G. Board Governance Manual (including Communication Policy, Conflict of Interest and Confidentiality Policy, External Service Provider Conflict of Interest Statement and Board of Trustees and Employees Conflict of Interest Statement).

Adopted June 19, 2017

CERTIFICATION

This certifies that the Investment Procurement Policy of the Teachers' Retirement System of the State of Kentucky meets best practices for investment management procurement as specified by KRS 161.430 (7).

William M. Landrum III

William M. Landrum III
Secretary of the Finance and Administration Cabinet
Commonwealth of Kentucky

20 June 2017
Date