Commonwealth of Kentucky

Pension Performance and Best Practices Analysis

Interim Report #1: Transparency and Governance

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In conjunction with:

PRM Consulting Group
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Introduction

Introduction

The Commonwealth of Kentucky sponsors three major retirement systems, collectively providing pensions and retiree healthcare benefits to tens of thousands of retired state, local government, school district, and nonprofit employees across the state. Within these three major systems, there are eight pension plans in all, each with different operating practices and benefit plan designs, covering specific employee groups.

For the pensioners and current workers within these covered groups, the reliability and security of these retirement programs are paramount. At the same time, these systems represent a significant investment for Kentucky's taxpayers, and their affordability and financial sustainability bear strongly on the capacity of the Commonwealth and its local governments to address other critical public needs.

Currently, while the condition, pressures, and dynamics vary across each of these three major systems and their component parts, the Commonwealth's retirement programs in the aggregate are among the most challenged in the nation. According to a recent credit rating agency analysis that evaluated each state's proportionate share of liability for public employee pensions as of FY2015, Kentucky systems had the worst overall ranking – with combined funding set aside at just 37.4 percent of the levels required to pay for their current long-term obligations.

FY2015 Worst-Funded Pension Ratios – Aggregate of State Liabilities		
	Median	**74.6%**
	Average	**73.2%**
46	Rhode Island	55.5%
47	Connecticut	49.4%
48	Illinois	40.2%
49	New Jersey	37.8%
50	**Kentucky**	**37.4%**

Source: Standard & Poor's, *U.S. State Pensions: Weak Market Returns Will Contribute to Rise in Expense*, September 12, 2016

More recently, the latest FY2016 actuarial valuation for the Kentucky Employees Retirement System (KERS) Non-Hazardous pension component of the program covering state civilian employees within the broader Kentucky Retirement Systems (KRS) reported a funded ratio of just 16.0 percent, down from 19.0 percent in FY2015. While funding levels are higher for the public safety, local government, teachers, and judicial and legislative programs, all of Kentucky's systems are underfunded and the aggregate challenges remain quite severe.

In this general context, the Commonwealth's Finance and Administration Cabinet, through a competitive process, has selected a team led by PFM Group Consulting LLC to develop a range of analyses that illustrate the current and projected financial condition of the systems, and draw on best practices nationally to provide options and recommendations for improvement and reform. Over the months ahead, the PFM Group team will report on these critical issues.

This first report is focused on ***transparency and governance*** for each of the Commonwealth's three major systems. In later reports, we will address investment performance, structural governance,

administrative structure and efficiency, actuarial and funding approaches, plan design, and other aspects of each of the three retirement systems.

Concerns regarding pension transparency and governance are not unique to Kentucky. As state and local pension funded ratios nationally have eroded, scrutiny of investment performance and the cost of investment options has increased. Further, increased asset allocations across many systems into alternative investments such as private equity and hedge funds[1] has generated new questions and challenges for measuring and reporting fees, costs, and performance. In addition, the increased availability of information and data generally across society has raised expectations for public sector transparency.

Within Kentucky, the Commonwealth's system with the largest membership, KRS, has been the focus of particular concerns in recent years – many directly relevant to all three major retirement systems. Not only has the KERS Non-Hazardous plan within the KRS experienced extraordinarily sharp declines in its funded ratio, but a series of audits and evaluations have surfaced issues related to the appropriateness of procedures, internal controls, disclosure policies, potential conflicts of interest, the engagement of placement agents, and the absence of standardized written investment policies.[2]

Between 2006 and 2014, four Chief Investment Officers have been appointed at the KRS, with at least one resignation due to audit findings. Compounded by this executive turnover, the KRS has a recent history of high investment management fees and relatively low returns, further elevating the importance of a transparency and governance review.

To address these and other concerns, Governor Bevin issued Executive Order 2016-340 on June 17, 2016 to reform the KRS, and the Kentucky Legislature has considered legislation to strengthen transparency and governance and transparency broadly across all three of the Commonwealth's retirement systems.[3]

- To help inform next step actions, this report addresses the following issues through a mix of benchmarking and best practices analysis: Fee and Performance Reporting
- Exceptions to Investment Disclosure Requirements
- Procurement Practices and Use of the Model Procurement Code
- Use of Placement Agents
- Disclosure of Member Benefits
- Board Member Disclosure/Conflict of Interest
- Board Structure and Qualifications

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[1] A hedge fund is an alternative investment vehicle with a goal of outperforming the market or providing a hedge against market changes, typically structured as a limited partnership. Third party investors such as pension funds, banks, and wealthy individuals invest in the partnership as limited partners while the hedge fund management group serves as the general partner. Hedge funds can use a wide range of strategies and tactics, but often employ a greater degree of risk and leverage than more traditional investments in pursuit of a higher return.

[2] Review of the Kentucky Retirement Systems Perimeter Park West, Inc.'s Holly Hill Land Purchase, Finance and Administration Cabinet Office of Policy and Audit, July 6, 2009; Examination of Certain Policies, Procedures, Controls, and Financial Activities of Kentucky Retirement Systems, Kentucky Auditor of Public Accounts, June 28, 2011.

[3] Senate Bill 2 (SB2) was introduced during the 2016 Kentucky General Assembly. It is considered the benchmark legislative initiative to address transparency (and, to a more limited extent, governance) issues across the Commonwealth's retirement systems. The provisions of SB2 were evaluated as a component of this report, and may be found in full at the following link: http://www.lrc.ky.gov/record/16RS/SB2.htm

- Staffing within the State Personnel System

Our review indicates that the Commonwealth's recent actions to reorganize KRS Board, to establish higher standards for appointment, and to enhance governance, reporting, contracting and personnel practices, are all aligned with best practices for governance, administration, and transparency.

Further recommended refinements and/or actions to institutionalize executive reforms by statute, as well as parallel measures to strengthen the Teachers Retirement System of Kentucky (TRS) and the Kentucky Judicial Form Retirement System (KJFRS), are summarized in the table that follows and detailed throughout this report.

Summary of Recommendations	
Recommendations	Considerations
Transparency	
Improve fee transparency for all systems by: • **Requiring reporting of actual dollar fees and expense ratios from all managers.** • **Adopting the Institutional Limited Partners Association (ILPA) Fee Transparency Initiative Template and reporting alternative investment results on that basis.** • **Making investment policy statements accessible.** • **Disclosing all performance, both net and gross of fees for the following time periods: current quarter, 1 year, 3 years, 5 years, 10 years and, to the extent possible, 20 or more years.** • **Reporting performance results for the plan and by asset class and manager, net and gross of fees.**	Follow industry best practices by making fee reporting and net investment performance results more comprehensive and transparent.
Improve internally managed expense transparency for all systems by reporting associated personnel, research/data service, and other operating costs separately from total investment and/or administrative expenses, particularly for index strategies.	Follow industry best practices by making all net investment reporting more comprehensive and transparent, and allowing comparisons between externally and internally managed portfolios.
Amend KRS 61.878 to allow for complete disclosure of all investment fees for all managers by modifying the unfair commercial advantage language so that it is limited to investment strategy information or other intellectual property, and not fees or the cost of investment services to the system.	Follow industry best practices by making investment manager fee information more comprehensive and transparent.
Post offering documents, but not investment manager contracts, publicly to the web site.	Posting investment manager contracts publicly would be beyond standard industry practice and likely have a greater negative impact on the ability to attract qualified managers than disclosing their fees.
Establish a clear written policy and procedure for procurement of investment managers and funds, but maintain exemption from the Model Procurement Code for investment managers.	Following the Model Procurement Code for investment managers would potentially inhibit the ability to react to markets and make changes to portfolios in a timely manner.
Restrict access to funds using placement agents either through prohibition of use of retirement system funds for placement agent fees, or under strict guidelines for disclosure, compensation and behavior.	Preserving flexibility to invest via placement agents may have some long-term benefits, but only under proper conditions. Otherwise, prohibiting use of placement agents would address concerns and should maintain an appropriate range of investment options.

Summary of Recommendations	
Recommendations	Considerations
Modify privacy protection of member benefit information through confidentiality restrictions in KRS 61.661 tailored to specific job classifications.	Retirement system member benefit information is treated as open records in some states, and there is a legitimate public purpose in having access to tailored data.
Review current KRS and TRS Conflict of Interest policies and the Kentucky Executive Branch Code of Ethics for additional opportunities to strengthen and clarify requirements.	Statute and policies in other states demonstrate greater detail on the responsibilities of members, particularly regarding campaign contributions and Board members acting in an individual capacity.
Governance	
Amend the KRS Board by statute to increase the number of executive appointments to the Board **and investment committee with investment experience by between one and four.**	Improve the oversight and stability of KRS by adding expertise to the Investment Committee, in line with requirements of states with a single fiduciary Board model or separate investment fiduciary Boards.
Amend the TRS Board by statute to add six appointments by the Governor to the TRS Board**, requiring two or more of the appointments to have investment experience.**	Increase the diversity of stakeholder perspectives on the Board, which was the only Board in the peer group with no executive or legislative appointments, and add formal investment experience requirements to the statute.
Require the advice and consent of the Senate for executive appointments to the KRS and TRS Boards.	Most of the 20 peer states reviewed provide for legislative appointment or oversight of Board members, providing additional input and check-and-balance on oversight. The KJFRS **b**oard already has direct legislative appointments.
Amend the KJFRS Board by statute to require the two executive appointments to have investment experience.	There is currently no formal investment experience requirement for Board members.
Consider exempting KRS senior investment officials, in addition to the Executive Director, from the state personnel system.	KRS has a need for the best possible tools for recruiting and retention in investment positions. Under the state personnel system, KRS may not have as much flexibility to offer market-based compensation packages to hire and retain appropriate staff expertise for the oversight of multibillion dollar investment programs and may face issues with prolonged vacancies. While a similar exemption may also be warranted for the overall chief executive officer overseeing all system activities, continued use of the state personnel system remains a reasonable approach for other non-investment professional, customer service, administrative, and support positions.

Transparency

Fee Reporting

The issue of fee transparency and performance reporting has been a major topic among state retirement systems in recent years, taking on even greater importance as allocations to alternative investments nationally have trended upward.[4] This is a direct result of the complex fee structure of many alternative investments, like private equity, and the difficulty in measuring the true costs incurred by investors. Although some guidance for disclosure has been provided by the Governmental Accounting Standards Board (GASB) and other organizations, such direction has not kept pace with the rise in alternative investments. In turn, this has led to inconsistent interpretations of the guidelines and significant variations in fee disclosure and performance reporting across state retirement systems.

Illustrating the varying degree of transparency and reporting among state pension systems nationally, the following table outlines the fee and performance reporting disclosed in the Comprehensive Annual Financial Report (CAFR) for each state.

Fee Disclosures	Overall Investment Manager Fees (external)	Carried Interest / Private Equity Related Fees (external)	Other Expenses (custodian, commissions, etc. - external)	Total Expenses (including internal costs)	Total Plan Performance (net/gross)
California	Yes	Yes	Yes	Yes	Multiple*
Georgia	Yes	Yes	Yes	Yes	Multiple *
Indiana	Yes	No	Yes	No	Net
Massachusetts	Yes	No	Yes	No	Gross
Missouri	Yes	Yes	Yes	Yes	Net
New York	Yes	Yes	Yes	Yes	Multiple *
North Carolina	Yes	Yes	No	No	Net
Ohio	Yes	No	Yes	No	Net
Oregon	Yes	Yes	Yes	Yes	Net
Pennsylvania	Yes	Yes	Yes	Yes	Net
Rhode Island	Yes	Yes	Yes	Yes	Net
South Carolina	Yes	Yes	Yes	Yes	Net
Tennessee	Yes	No	Yes	No	Gross
Virginia	Yes	Yes	Yes	Yes	Net

*States marked as having "Multiple" reporting methods have two funds that report differently from one another.

Even among the various Kentucky retirement systems, fee disclosure practices have varied, as shown in the table below.

[4] An alternative investment is an asset that is distinct from the conventional investment classes, such as stocks, bonds and cash. Alternative investments are typically held by institutional investors (including pension funds) or high-net-worth individuals because of the complexity and more limited regulation of such investments. Examples of alternative investments include private equity, hedge funds, real estate, and derivatives contracts.

Transparency

Fee Disclosures	KRS	KTRS	KJFRS
Overall Investment Manager Fees	Yes	Yes	Yes
Carried Interest / Performance Fees	Yes	Not Specified	N/A*
Other Expenses (custodian, commissions, etc.)	Yes	Yes	Yes
Underlying Manager Fee Detail	No	Yes	N/A
Total Plan Performance (net/gross)	Gross and Net	Gross and Net	Gross and Net
Asset Class Performance (net/gross)	Gross and Net	Gross	Gross
Underlying Manager Performance (net/gross)	Gross and Net	No	N/A

**The KJFRS does not use underlying managers, but rather relies on its adviser to purchase individual securities, resulting in a finding of "N/A" for some disclosure categories.*

Although Kentucky's retirement systems have not historically provided the level of transparency now recommended by organizations like Pew and ILPA, the systems are trending in the right direction. Of particular note, Executive Order 2016-340 has added additional requirements to the fee reporting standards for KRS by requiring that

> *"investment holdings, fees and commissions shall be disclosed by each individual manager, including underlying individual managers in fund of funds and individual underlying holdings, and investment fees and commissions shall include any profit sharing, carried interest, or any other partnership incentive arrangements or agreements."*

To better address such fee transparency concerns and inconsistencies nationally, in 2015, a group of institutional investors announced the launch of a project called the Fee Transparency Initiative. The goal is to implement "best practices" for reporting the transparency of fees. The group consists of CalPERS, New York Teachers Retirement System State Teachers Retirement System of Ohio, and others, led by Institutional Limited Partners Association (ILPA).

The Fee Transparency Initiative resulted in a template to document all types of compensation paid to fund managers, including incentive compensation, profit sharing, and expenses that managers and their affiliates receive. The template is in a format that is comprehensive and based on a standard set of guidelines, but that also allows for some flexibility based on the unique fee structures for various types of investments. It is recommended that the template be completed on a quarterly basis, with expenses reported on a year-to-date basis to ensure timely delivery. As the industry advances and evolves, it is anticipated that the ILPA will make further revision to the ILPA template going forward. For reference, the 2016 ILPA template is included as an appendix.

Transparency

In 2016, the Pew Charitable Trusts also published a best practices guide for fee transparency ("Making State Pension Investments More Transparent," February 2016), which is outlined in the table below, along with a brief summary of how Kentucky's retirement systems now compare against these standards. The full Pew report is also attached as an appendix.

Fee Transparency Best Practices	KRS Status	TRS Status	KJFRS
Adopt comprehensive fee-reporting standards, such as those proposed by the Institutional Limited Partners Association (ILPA) Fee Transparency Initiative	External investment manager fees as an annual percentage of assets are reported on website annually but only include publicly stated fee, not the actual fee negotiated or paid by KRS. Less transparent costs are not available.	Dollar amounts paid to each external manager are included in CAFR on website. Investment manager fee schedules and more detailed fee information are not provided separately on the website.	The actual dollar amounts paid are provided on their website. Fee schedules, assets and more detailed information are not provided. Fee-reporting standards proposed by ILPA would not be applicable to KJFRS at this time.
Make investment policy statements transparent and accessible	Investment policy statement is available on the website.	CAFR includes some information on asset allocation and investment policy. A separate investment policy document is not available on the website.	Investment policy statement is available on the website.
Disclose bottom-line performance, both net and gross of fees	Performance is available on website on a monthly and quarterly basis. Net of fees performance is shown in the consultant's report since inception. Gross of fees is shown for attribution purposes for select time periods only.	Gross of fee performance is available on website as of the most recent fiscal year end. Net of fees performance is reported for 2014-2016 fiscal years in the CAFR.	Performance is available on website on a quarterly basis. Net of fees is only shown for the total portfolio for the past 18 months. Gross of fees is shown for trailing 20 years.
Report results by asset class, net and gross of fees	Net and gross of fees is shown for individual investment manager and asset class levels.	Gross of fees performance is shown for the asset class level. Individual investment manager performance is only shown for the "Alternative Credit" category.	Gross of fees performance is shown for asset class level.
Expand reporting to include longer-term performance results (20 years)	Total plan performance is shown for periods up to 10 years and since inception. Asset class performance is shown for periods up to 25 years and since inception.	Total plan and asset class performance is shown for trailing 20 years but not since inception.	Total plan and asset class performance is shown for trailing 20 years but not since inception.

Source: The Pew Charitable Trusts: "Making State Pension Investments More Transparent," February 2016

Performance Reporting

In addition to the disclosure of fees paid to investment managers and other service providers, performance reporting has also been included in discussions of improved transparency and consistency. As shown in the preceding table, the Pew Charitable Trusts recommends calculating and reporting performance both gross and net of fees. This should not only include the standard management fee, but all additional performance-based fees and other costs paid to the managers.

Similar to the lack of consistency in fee transparency, performance reporting among state retirement systems also varies. According to the 2016 Pew research, a majority of states report net of fees, 15 states report gross of fees, one state (South Dakota) discloses performance both net and gross of fees, and Kentucky is one of seven states to provide performance in a different way depending on the plan. It is important to note, however, that Pew's analysis is based on information found in each plan's CAFR, which may differ from the annual or quarterly performance reports posted to their websites.

2016 SB2, as proposed, would have established additional requirements related to performance reporting and related information that would be posted to the retirement system websites. Each Kentucky system would provide:

> *"an update of net investment returns, asset allocations, and the performance of the funds against benchmarks adopted by the board for each fund and for each asset class administered by the board. The update shall be posted on a quarterly basis for fiscal years beginning on or after July 1, 2008."*

KRS and TRS have been providing performance both gross and net of fees in recent reports.

Fee and Performance Reporting Recommendations

We believe that the general trend towards greater transparency of investment fees and performance is a positive one that reduces the risk of excessive fees and conflicts of interest between Board members and service providers. Better disclosure should also allow for better decision making by the Board members as they will have easier access to relevant information. Although there is some level of concern that disclosing all fees paid to investment managers could limit the pool of managers willing to negotiate lower fees and do business with the retirement systems (due to the possibility of their fees becoming public, thereby reducing their ability to negotiate fees with other current and future clients), we feel that the benefits of increased transparency outweigh this concern in almost all circumstances.

In addition to greater transparency of external manager fees, the retirement systems should also work to improve the level of transparency regarding the costs of internally managed investments. Both KRS and TRS deploy internally managed strategies for some investments, but include such investment-related expenses as part of the systems' broad administrative costs. These assets have a significant

weight in the portfolios (23 percent in KRS and 42 percent in TRS) and all expenses related to the management of these accounts should be identified, appropriately allocated, and fully disclosed along with the other investment fees to provide greater clarity about both investment costs and the cost of non-investment administration. Disclosure of these costs to each Board Investment Committee in detail and to each Board in summary, just as now done for the externally managed funds, will provide better information for decision-making.

For example, Missouri provides a line item in its CAFR labeled “internal investment activity expenses” and then provides a detailed breakdown into various categories (i.e. personnel, facilities, software, education, travel, research/data services, memberships, etc.) related to internal investment activity. Without this information, it is impossible to fully evaluate whether or not it makes sense to manage these assets internally or outsource them to a third-party. The costs related to index strategies, in particular, should be compared to external passively managed funds, which typically have low management fees.

Overall, the guidelines outlined in KRS Executive Order 2016-340 and the proposed 2016 SB2 represent significant improvements over the historical standards followed by each of the three Kentucky retirement systems. Building on these measures toward full transparency and accountability, we strongly recommend that the retirement systems follow the best practices established by the Pew Charitable Trusts, which include the adoption of the ILPA fee reporting template.

Although not specifically addressed in the best practices matrix on page 12, we would also specify our recommendation that:

- Manager fees should be reported as both dollars and expense ratios.
- Performance for each underlying manager should be reported both gross and net of fees.

Each Board, in accordance with its fiduciary responsibilities, should require detailed fee compensation information from each of the managers so that Board members can individually and collectively be knowledgeable and understand all fees and compensation being paid to the managers and their related parties. This information should be reviewed in detail by each Board Investment Committee and investment staff, with summary reports to be reviewed by each full Board and posted on each system’s website for availability to the general public.

Among the types of fees the Boards should require are those provided through the ILPA template (as applicable) including:

- Management Fees – Gross of Offsets, Waivers & Rebates
- Management Fee Rebates
- Advisory Fees
- Broken Deal Fees
- Transaction & Deal Fees

- Directors Fees
- Monitoring Fees
- Organizational Costs
- Placement Fees
- Capital Markets Fees
- Fee Waivers
- Partnership Expenses - Non-Overhead - Paid to GP and Related Parties
- Partnership Expenses - Overhead - Paid to GP and Related Parties
- Partnership Expenses - Non-Overhead - Paid Non-Related Parties
- Partnership Expenses - Overhead - Paid to Non-Related Parties

As it pertains to public information, it is also important to provide gross and net performance statistics for each of the managers, asset classes, and systems to the public on no less than an annual basis. Currently, the Commonwealth's Public Pension Oversight Board (PPOB) receives such information quarterly, which is good practice. Along with performance information, expense and compensation data should be provided for each manager separately using at least the following categories (as appropriate): manager fees and expenses (total direct and indirect compensation), fund advisory fee, operating expenses, carried interest, and all other expenses.

Exceptions to Manager Disclosure Requirements

In much the same way that there has been an industry-wide trend towards greater fee transparency, there has also been a demand for greater overall transparency of all third-party contracts, policies, and other related documents. Although there is no single set of best practices regarding the disclosure of such documents, much of the concern is linked to the issue of fee transparency as seen, for example, in The Pew Charitable Trusts best practices and ILPA Fee Transparency Initiative.

In Kentucky, both Executive Order 2016-340 and proposed 2016 SB2 outline a set of disclosure standards such that *"all contracts or offering documents for services, goods, or property purchased or utilized by the systems"* should be posted to system websites and readily accessible by the public.

At the same time, KRS 61.878 includes an exemption from publicly reporting any information that may compromise the retirement systems' ability to be competitive and would *"permit an unfair commercial advantage to competitors of the entity that disclosed the records."* Proposed 2016 SB2 addresses this exemption, but also states that *"no provision of this section or KRS 61.878 shall exclude disclosure and review of all contracts, including investment contracts, by the board, the Auditor of Public Accounts, and the Government Contract Review Committee established pursuant to KRS 45A.705 or the disclosure of investment fees and commissions as provided by this section."*

A primary concern that sometimes leads systems to limit their document disclosure is related to the fees that have been negotiated with investment managers, particularly in the private equity space. If investment managers are aware that their fees will be publicly available, they may be less willing to

negotiate discounted fees or even to work with a retirement systems at all. In turn, this may negatively impact the quality of investment managers in the portfolio and, therefore, the investment returns.

Despite this concern, certain states like Missouri and California have enacted legislation to require the full disclosure of all such investment fees and arrangements. Although these states do not provide the actual contracts for each investment manager / advisor on their website, their CAFR is available and provides detail of fees paid to each investment manager, advisor, and other related third-party firms. There is also the ability to submit a public request for information, which may or may not include contractual agreements for service providers.

Recommendations for Exceptions to Manager Disclosure Requirements

Although we fully understand the concerns associated with providing detailed information regarding investment fees and related documents to the public, we believe the industry trend is towards greater transparency and would recommend that Kentucky be at the forefront of that trend. As noted above, the guidelines provided by The Pew Charitable Trusts and the ILPA serve as best practices regarding fee disclosure. In both cases, there are no exemptions for sensitive information like reduced fees negotiated with alternatives managers. Accordingly, in keeping with the goal of strong disclosure, we would recommend amending / removing the exemptions outlined above in KRS 61.878 and related statutes to allow for complete disclosure of all investment fees by KRS, TRS, and KJFRS. This would align Kentucky's disclosure policy with what we believe are industry best practices and mirror what is already being done by Missouri and California, among others, which are viewed as leaders in the trend towards greater transparency.

More specifically, we recommend:

- Complete disclosure of fees, expenses, and other compensation paid to managers and other service providers should be required by statute, with reports on at least an annual basis to each Board investment Committee and staff in full detail.
- Summary level reports should be developed by each Board investment Committee and staff for presentation to each full Board on at least an annual basis, with these summary reports made available to the public.
- The ILPA template should be the minimum standard for reporting on partnership-type and other alternative investments and managers.

Offering documents, such as prospectuses or offering memorandums, typically contain standard disclosure language on the investment objectives/risks and firm structure that must be provided to a prospective investor before execution of a contract. Because these documents are readily provided by the investment manager prior to entering into an agreement, we do not believe the information contained in these documents is sensitive enough to warrant exclusion from public disclosure. As a result, we would recommend that these documents be made publicly available to provide interested parties with additional information on the investments within the plans.

With regard to contracts with investment managers, however, we believe that publishing such detailed information would be beyond the scope of best practices for transparency and could have a negative impact on the systems' ability to hire quality investment managers. While even the public disclosure of investment manager fees may cause some managers to shy away from doing business with the Commonwealth, we believe that this would be a relatively small group, with such action warranted by the importance of greater transparency. The public disclosure of the actual agreements entered into between the Commonwealth and investment managers, on the other hand, would more likely lead to a significant number of quality managers that are unwilling to manage assets for the systems.

Such investment manager contracts typically contain sensitive information related to most-favored-nation clauses, investment strategies or procedures, personnel information, indemnification language, opportunities for co-investment, and/or other proprietary details about the managers' business and approach that they would not want made public. We believe it is important that all such information be available to and reviewed by the systems' investment staff and Board Investment Committees, and that such review by well-qualified representatives provides sufficient protection for the systems and the public.

Accordingly, we recommend:

- Prospectuses, offering memoranda, and other standard offering documents should be made available on the systems' publicly available websites.
- Final manager contracts should be reserved for detailed review by each system's Board Investment Committee and staff.

Procurement Practices and Use of the Model Procurement Code

Purchasing regulations and policy for the Commonwealth's retirement systems have varied over the years, with the KRS, TRS, and KJFRS now exempted from the general State Model Procurement Code. The KRS and TRS rely on written procurement policies adopted by their respective Boards to guide purchasing, while the KJFRS has no written procurement policy.

In 2016, Kentucky's Legislative Research Commission (LRC) staff surveyed all 50 states and the District of Columbia regarding practices nationally for including or excluding state retirement systems from general purchasing codes. As shown in the resulting LRC analysis as presented to the Commonwealth's Public Pension Oversight Board (PPOB), 29 states (57 percent) had no procurement code exemption for their state retirement system, while 20 states (38 percent) had an explicit exemption from the procurement code for their state retirement system.

For this current transparency report, the PRM Consulting group – a member of the project team – conducted a survey of a 20-state benchmarking group also used to examine Board composition. This survey group will also be used in later reports for benchmarking benefit plan design, investment performance, and other system features. These systems include the seven states contiguous to Kentucky, other regional states of similar scale, and certain states where, like Kentucky, teachers are not covered by Social Security.

Transparency

Similar to the results found by the Pension Oversight Board presentation, the PRM 20-state survey found that explicit exemptions from state procurement laws are common, but not universal. Of note, Virginia explicitly states that procurements by the retirement Board of trustees are not subject to the state procurement act, while Indiana statutes note that general policies do not apply to alternative investments, thus giving their investment committee increased leverage to invest in alternative arrangements. Some states, such as Ohio and Missouri, allow their Boards to set up their own policy regarding selecting vendors for investment advisory services, and Indiana and Illinois place the authority for entering contracts for investments and advisory services in alternative entities, in the hands of the Executive Director and Illinois Board of Investment respectively.

The following chart includes detail about each state's exceptions, if any, included in the PRM review.

State	Retirement System Exemptions from General State Purchasing Requirements
Illinois	The system is exempt from the State's model procurement code, but does have a written procurement policy. The Illinois State Board of Investment can directly invest pension assets in public market, private, and real estate investments. The Board may not delegate management functions, but can arrange personalized investment advisory services
Indiana	Executive Director has full authority to enter all contracts on behalf of the system. General procurement policies apply except for contracts for alternative investments
Kentucky	Exempted from state purchasing laws. Contracting authority lies with each Board
Maryland	Two candidates for vendors required to be submitted to the Board for consideration and possible interviews
Missouri	The CIO oversees the system's Chief General Asset Consultant who serves under contract of the Board. The CIO can hire outside service providers provided the hiring process follows the Board's Investment Policy
Ohio	Board establishes policy for selecting investment manager
Virginia	The selection of services related to the management, purchase, or sale of authorized investments, actuarial services, and disability determination services shall be governed by the standard of care in § 51.1-124.30. Procurements through the Board are not subject to the State Procurement Act
Rhode Island, South Carolina, South Dakota, Tennessee, West Virginia, Wyoming have no retirement system exemptions from State procurement policies	

Recommendations for Procurement Practices and Use of the Model Procurement Code

Procurement Codes work best when dealing with distinct, ministerial processes or tangible services (like building a building or processing payroll), and are generally less effective when dealing with ways of thinking and other more complex services and approaches.

In addition, investment strategies and capital markets can change quickly based on newly released economic data or political instability and the resignation of a portfolio manager can greatly disrupt the ability of an investment manager to perform in the future. Being tied to a stringent procurement process, such as the Model Procurement Code, would greatly reduce the ability of the systems and their investment consultants and staff to make changes to the portfolios in a timely manner, potentially to the detriment of investment performance.

Instead, the systems would be better served to stringently evaluate the process for identifying, evaluating and following managers for inclusion in a search process. When agreed to, all managers should be evaluated against such an internal process and presented for consideration and approval under this consistent and structured approach. This process, which would range from the start of the search process to the signing of the manager contract and investment of assets, should be well documented and made public to ensure complete transparency and accountability regarding the selection of investment managers and strategies.

As long as a sound and structured selection process is in place, with strong transparency and disclosure requirements, we do not recommend that the retirement systems adopt the Model Procurement Code for the hiring and firing of investment managers. To be clear, however, use of the Model Procurement Code would be entirely appropriate for other service providers, including investment consultants, custodians, and operational vendors and suppliers.

In addition, even if the Commonwealth were to maintain the Model Procurement Code as a vehicle for the selection of some investment managers, we recommend the continued exemption of investment in passively managed index funds that simply mirror a benchmark and provide market returns at a low cost. In the event that active and specialty managers were included in the procurement process, the exemption for passively managed index funds would provide the portfolios with the flexibility to gain market exposure quickly without having to wait for the procurement process to be completed. In turn, this would prevent the portfolios from remaining invested in poorly performing managers or strategies for an excessive period of time due solely to rigid and time consuming procurement procedures.

In sum, we recommend:

- The selection of investment managers by the Commonwealth's retirement systems should remain exempt from the Model Procurement Code to maintain maximum flexibility and speed, so long as the processes involving such managers are fully documented, transparent, and consistent.
- Other retirement system purchases and contracting may appropriately be covered by the Model Procurement Code, including the selection of any consultants engaged to provide global direction on asset allocation, manager selection, and other elements of investment strategy and management.

- Purchasing in support of general, day-to-day operations may also be appropriately covered by the Model Procurement Code.

In general, it may also be noted that Kentucky's purchasing system provides for some exemptions from standard competitive bidding procedures when well supported by operational requirements and approved in advance. With this existing flexibility, the need for full exemption from the Model Procurement Code can, again, be limited solely to the selection of investment managers.

Use of Placement Agents

A placement agent is an individual or firm hired to act as a marketing intermediary, or "middleman" for an asset manager, to sell its investment products to investors – linking investment firms with public pension funds. Placement agents act as third-party marketers, and are neither employees of investment managers nor subject to manager supervision of their activities.

Because of the lack of relationship clarity and managerial oversight, investors are often unaware that placement agents are paid marketers for the managers that have retained them and may be unfamiliar with the sometimes large amounts of compensation placement agents can receive for directing investors. Placement agent fees can be significant and typically average about 1 percent of the total investment, which is often more than traditional equity and fixed income managers charge for their services in total.

According to a study conducted by Stephen McKeon of the University of Oregon, and Matthew D. Cain, a financial economist at the SEC based on data from Preqin, a leading source of data and intelligence for the alternative assets industry, in 1991, placement agents were almost nonexistent. By mid-2014, however, they were involved in 41 percent of the fund-raising for North American private equity firms and became a staple of some pension funds. For example, the California Public Employees' Retirement System (CalPERS), invested in 784 funds using placement agents from 1991 to 2011, according to Preqin. Of those investments, approximately 27 percent of the funds CalPERS invested in during that time had a placement agent. Further, some of the placement agents made campaign contributions to Board members in a pay-to-play scenario that resulted in a serious corporate governance black eye for CalPERS.

The reason systems allow placement agents is the perception that placement agents can connect pension funds to lesser-known private equity funds that might produce high returns. Similar to real estate agents, placement agents can also serve as information sources, guiding pension funds through the private equity process and helping them select better investments.

Placement agent fees are generally paid directly by money managers to the agents for securing investors such as public pensions. However, placement agent fees are ultimately associated with the fund fees paid by investors to managers because most money managers will need to account for this expense in their overall fund fees so that their intended revenue is not reduced. These fees are not easily identified by Board members, thus resulting in relationships of middlemen obtaining millions of dollars in fees.

Transparency

KRS has, like many other state systems, allowed placement agents to introduce investment managers – leading critics to question the size of the fees incurred and the nature of the relationships and investment decisions involved. As alluded to on page 5, previous audits and reviews identified payments to placement of $13 million over one five-year period, found issues with following controls and procedures regarding their use, and resulted in SEC investigation. The TRS and KJFRS have not used placement agents.

Similarly, the availability of large sums of fee payments, coupled with often long-term relationships and the lack of transparency surrounding placement agent fees, has led to instances of real or perceived corruption nationally – and ultimately to some states now banning the use of placement agents in their public pension funds altogether. For example:

- The former CEO of CalPERS pled guilty to conspiracy to commit bribery.
- The former Controller of New York State went to jail over a pay-to-play scandal involving placement agents.
- A Dallas money manager in 2009 pleaded guilty to corruption charges in New York for paying kickbacks to a placement agent who doubled as the chief fundraiser for that state's comptroller.

Such events led to the City of New York to ban placement agents from all five of their pension funds across all investment classes, and New Mexico and Illinois have also banned placement agents.

In an alternative approach, the following states passed legislation requiring placement agents to register as political lobbyists and to disclose their compensation received.

States Requiring Placement Agents to Register as Lobbyists	
California	New Jersey
Florida	North Carolina
Kentucky	Ohio
Maryland	Texas

For Kentucky, as a result of past placement agent scandals, the Kentucky General Assembly amended the definition of lobbyists as described above in 2012, and prohibited KRS, TRS, or KJFRS funds to be used to pay placement agents that are not registered with the SEC. In addition, the KRS Board adopted a Manager and Placement Agent Disclosure Policy, requiring full disclosure of the existence of placement agents and the fees paid to them by investment managers. The policy includes the disclosure of any conflicts of interest, political contributions, services, and fees paid related to investments in KRS. This policy went into effect in August 2012.

Other states adopting placement agent disclosure rules include the following:

States with Placement Agent Rules or Disclosure Policies	
Indiana	Oregon
Massachusetts	South Carolina
Missouri	Virginia

Tennessee and New Jersey have also implemented disclosure rules, using the SEC final 2010 rules and requiring placement agents to be registered with the SEC, FINRA, or similar state agency.

The Missouri State Employee Retirement System (MOSERS) was an early adopter of alternative investments, some with placement agents, and yet has still been considered a successful system with good governance and solid investment policies. MOSERS understood the risks and limited familiarity of some Board members with such investments and practices, so became one of the first systems to adopt a formal placement agent disclosure policy, as cited below:

- *Use of placement agents is recognized as a useful tool to be able to invest in uniquely positioned investment firms. However, external service providers are required to provide placement agent information prior to contracting with MOSERS. Information includes a description of fees arrangements, and information on SEC and/or lobbyist registration.*

The McKeon & Cain study referenced above also found that there can be a "too close" relationship with a pension fund and placement agent. It found that when a pension fund begins to invest with a single placement agent, trouble often ensues. In the 20-year period of the study, only three such firms had exclusive relationships with a pension fund. All three – Arvco Capital Research, the Wetherly Capital Group, and Diamond Edge Capital Partners – had employees convicted in pay-to-play scandals.

The following table includes a list of the top 15 public pension funds invested in private equity and the percentage of their investments that employ a placement agent as of 2011. Please note that this analysis does not indicate whether the given pension fund invested through a placement agent or directly with the fund for any given investment.

Rank	Limited Partner	Type	# of Investments	% With Agents
1	California Public Employees' Retirement System	Public Pension	784	27.4%
2	Pennsylvania State Employees' Retirement System	Public Pension	404	21.7%
3	California State Teachers' Retirement System	Public Pension	377	26.4%
4	State Universities Retirement System of Illinois	Public Pension	303	15.6%
5	Michigan Department of Treasury	Public Pension	301	19.0%
6	State of Wisconsin Investment Board	Public Pension	274	23.9%
7	Washington State Investment Board	Public Pension	273	18.1%
8	Oregon State Treasury	Public Pension	273	32.9%
9	Illinois Municipal Retirement Fund	Public Pension	272	22.7%
10	Pennsylvania Public School Employees' Retirement System	Public Pension	269	35.4%
11	Virginia Retirement System	Public Pension	254	18.0%
12	Regents of the University of California	Public Pension	253	21.8%
13	Los Angeles Fire and Police Pension System	Public Pension	245	29.0%
14	San Francisco City & County Employees' Retirement System	Public Pension	237	22.2%
15	Los Angeles County Employees' Retirement Association	Public Pension	236	16.5%

Table above drawn from a league table ranking of the top 20 U.S. investors in private equity (i.e., limited partners) ranked by number of investments. In addition to the public pension funds listed above, endowments and funds of funds are also included in the overall top 20. The final column reports the equal-weighted percentage of funds which employ a placement agent. Data as of 2011.

Recommendations Regarding Use of Placement Agents

Among other states, here is a great disparity in placement agent rules, ranging from bans to various levels of disclosure requirements. In some cases, placement agents must register as lobbyists. The SEC has also played a role in regulating the use of placement agents, requiring investment advisors to work with agents who are registered with the SEC or with a broker dealer. Most states, like Kentucky, require the complete and timely disclosure of all relationships of intermediaries like placement agents.

There is no global best practice for dealing with the placement agent issue. Different jurisdictions and systems have developed policies to fit their particular situations. For organizations with large investment teams like CalPERS, perhaps the value of a placement agent is minimized. For other smaller organizations, the placement agent is a way to gain visibility into a manager that would not otherwise be gained. Regardless of the investment value, the issues relating to compensation (transparency and reasonableness) and governance (no self-dealing or conflicts of interest) applies to all. As a general rule, we believe that investing in funds represented by placement agents can be warranted <u>in some, specific circumstances</u> and can help add value to a portfolio. As such, preserving flexibility to invest via placement agents may be beneficial to the systems, but only if properly monitored and documented to help avoid the aforementioned pitfalls.

The current KRS policy allows for the use of placement agents as long as all relationships, fees, and status as a registered lobbyist are fully disclosed. The proposed legislation in 2016 SB2 would implement a further significant change by stating that “no funds…including fees and commissions paid to an investment manager, private fund, or company issuing securities, who manages system assets, shall be used to pay fees and commissions to placement agents.” Given the typical fee arrangements between placement agents and investment managers, this would likely prevent the retirement systems from investing in funds using placement agents at all.

The Commonwealth could reasonably sustain a complete or effective ban on placement agents through an approach like SB2. If the Commonwealth wished to preserve a somewhat larger range of investment options in the long term, the following recommendations would help guard against potential abuses:

- The systems should reserve the potential benefits of placement agents in limited circumstances while simultaneously implementing strict guidelines for compensation and behavior.
- Much as with lobbyists or other government relations professionals assisting businesses with navigation of public purchasing processes, the impact of any use of placement agents should be closely monitored and should adhere to the following guidelines:

  - Placement agents should only be allowed as a way to access small, less visible managers, never for larger funds that are easily accessed directly by system staff (i.e. $300M in assets vs. $1B).
  - Placement agents must register as a broker-dealer with the Securities and Exchange Commission (SEC) and with the Commonwealth as a lobbyist to help ensure compliance with rules relating to conflict of interest and self-dealing, among other issues.

- The placement agent, investment manager, the internal investment team, and the Board should all be required to fully disclose any relationships to ensure no conflicts or self-dealing exist during the consideration of an investment involving a placement agent.
- Any real, potential, or perceived conflicts of interest involving the system Boards or staff should require the recusal of any involved individuals during consideration.
- There should be full disclosure of compensation to the placement agent (term, duties and amount) and to the external investment managers or advisors, using full disclosure formats such as the ILPA template, so that the Board can consider the reasonableness of all compensation and other factors.

Disclosure of Member Benefits

The account information and actual or estimated retirement annuity amounts for active and/or retired members of KRS, TRS, and KJFRS has been protected as confidential information exempt from the Federal Freedom of Information Act or similar state open records requests, based on the KRS 61.661 statute.

In recent months, The Bluegrass Institute, an independent Kentucky public policy research and educational organization, circulated a "transparency pledge" that would require amending this exemption specifically for legislators and their account information. Since legislators receive reciprocity for service in other governmental retirement systems, the pledge required that any service in KRS, TRS, or KJFRS be included and factored into the estimates that would be made available for disclosure. The Bluegrass Institute reports that 40 of the incoming representatives and a portion of senators signed the pledge.[5]

The determination of whether this information is or should be public is entirely a state legal and policy decision. Our review of the 20 other benchmark retirement systems indicated at least 10 will provide this information for employees generally. In six of those cases, batch files have been made available for third parties to post all data on a searchable web site, either by transparency-oriented non-profits or news sites. Alternatively, a system could post such information directly.

The State of Florida has a clear and detailed Public Records Policy, and "will not produce or generate information that does not already exist in the division's records or a member's retirement account file. The division will not calculate an estimate of an FRS member's pension plan retirement benefit in response to a public records request and will only release previously calculated estimates of retirement benefits."[6] The Florida Policy exempts from disclosure a large number of job classifications or members of certain job classifications based on their duties.

We have to date only confirmed several other benchmark states that treat pension benefit information as confidential. Virginia prohibits disclosure of personal information from public information requests based on privacy considerations. Indiana statute *"provides that Fund records of individual members and membership information are confidential, except for the name and years of service of a fund member."*

[5] http://www.bipps.org/tag/legislative-transparency-pledge/
[6] http://www.dms.myflorida.com/workforce_operations/retirement/public_records

Recommendation for Disclosure of Member Benefits

Disclosure of pension benefit information is not uncommon, and in the case of legislative benefits, public interest is understandable given the reciprocity benefits provided to members as well as the overall distress of Kentucky's retirement systems. A tailored policy applying to specific job classifications or members similar to Florida's is reasonable, although again the definition of what information is private is a state prerogative.

Board Member Disclosure/Conflict of Interest

KRS and TRS both require Board members to sign a Conflict of Interest statement in addition to ethics standards that are applicable under KRS Chapter 11A. We reviewed the Conflict of Interest statements and applicable underlying state statute of several other peer states in order to identify potential gaps. While a full review of ethics laws and rules could require its own report, we have several observations:

- The Board statements and KRS Chapter 11A do not address campaign contributions. Previous Executive Branch Ethics Commission advisory opinions have specifically clarified that the "Code of Ethics does not affect [the] ability to accept campaign contributions."[7] We found that similar policies in California, Indiana, Missouri, and Pennsylvania addressed campaign contributions, with particular reference to prospective contributors that are contractors or have business with the retirement system.
- The Board statements and KRS Chapter 11A do not define or circumscribe the individual authority of members. Other similar policies obligate the individual member to:
    - Take steps to avoid prohibited communications with vendors or individuals seeking to influence the Board
    - Refrain from communicating on business and investment-related matters with staff members other than the Executive Director (or in the case of KRS also the CIO) outside of Board or committee meetings, and otherwise recognize the lack of authority of individual members of the Board acting individually
    - Limit public speaking to discussion of existing Board policy or decisions
    - Avoid discussing specific benefit or annuity amounts with system members.

The Indiana and Missouri policies provide good examples of more detailed and proscriptive Conflict of Interest policies.

[7] Executive Branch Ethics Commission, *ADVISORY OPINION 11-08,* December 2, 2011

Governance

Overview of the Retirement Systems and Structures

The Commonwealth of Kentucky sponsors three major retirement systems. These systems have a variety of governance structures, membership demographics, types of participating employers, plan design features, and funding approaches and challenges.

As noted in the Introduction to this report, PFM's engagement with the Commonwealth encompasses a range of analyses to assess and illustrate the current and projected financial condition of the systems, and to draw on best practices nationally to provide options and recommendations for reform. This initial report focuses on transparency and select governance issues. In future reports, we will address investment performance, administrative structure and efficiency, actuarial approaches, plan design, and other elements of each of the three retirement systems, including additional comments and recommendations regarding governance that extend beyond the issues addressed within this initial report.

- The Kentucky Retirement Systems (KRS) Board of Trustees, which includes 17 members, oversees five plans:
    - The Kentucky Employees Retirement System (KERS) Non-Hazardous and Hazardous plans for state and state-related workers in non-hazardous (i.e. civilian) and hazardous (i.e. corrections, etc.) job classifications, who are represented on the Board by two active or retired members of the plans elected by active and retired members;
    - The State Police Retirement System (SPRS) for state troopers, who are represented on the Board by one active or retired member of the plan elected by active and retired members;
    - The County Employees Retirement System (CERS) Non-Hazardous and Hazardous plans for local government and school administrative and support workers in non-hazardous and hazardous job classifications, who are represented on the Board by three active or retired members of the plan elected by active and retired members.
    - The Board also includes the Secretary of the Commonwealth's Personnel Cabinet (*ex officio*) and, per Executive Order 2016-340, ten appointees of the Governor, three of whom are selected from a list of nominations provided by each of the Kentucky League of Cities, Kentucky Association of Counties, and Kentucky School Boards Association.
- The Teachers' Retirement System of Kentucky (TRS) Board of Trustees supervises the plan for teachers at public schools and universities in the state, who are represented by four active elected members, one retired member, and two non-teaching (lay) elected representatives. The Commonwealth Commissioner of Education and State Treasurer serve ex officio, for a total of nine Board members. There are no executive or legislative Board appointments.
- The Kentucky Judicial Form Retirement System (KJFRS) supervises the Kentucky Judicial Retirement Plan and the Kentucky Legislators Retirement plan, which are represented by eight Board members – three appointed by the state Supreme Court, one by the President of the

Kentucky Senate, one by the Speaker of the Kentucky House of Representatives, one by the President and Speaker jointly, and two by the Governor.

Summary level data regarding membership, liabilities, and funded status for each of these systems and major plans is provided in the following table.

Commonwealth of Kentucky Retirement Characteristics FY 2016

System	Kentucky Retirement Systems					Teachers' Retirement System of Kentucky	Kentucky Judicial Form Retirement System	
Funding*	68% State non-hazardous, 98% State hazardous; 142 nonprofit and othersState Employees/Funding			Local Govt Employees		95% State	State	
Plan	Kentucky Employees Retirement System: Non-Hazardous	Kentucky Employees Ret. System: Hazardous	State Police Ret. System	County Employees Ret. System: Non-Hazardous	County Employees Ret. System: Hazardous		Legislators' Retirement Plan**	Judicial Ret. Plan**
Active Members	37,779	3,959	908	80,664	9,084	71,848	101	237
Inactive Members	10,399	481	65	14,357	775	9,240	42	18
Retirees Receiving Benefits	44,004	3,966	1,515	56,339	8,563	51,563	200	330
Unfunded Actuarial Liability ($ in Millions)	$11,112.4	$377.2	$540.6	$4,541.1	$1,565.3	$14,531.3	$15.2	$115.0
Funded Ratio	15.97%	59.73%	30.26%	59.00%	57.74%	54.60%	85.10%	72.07%

* Information shown as of fiscal year ended 6/30/2015
** Information shown as of fiscal year ended 6/30/2015 as UAL is calculated biannually.

NOTE:
Retirees Receiving Benefits - Number includes retired member and beneficiaries
Inactive members listed are inactive vested members non-vested inactive members are not referenced

Board Structure, Qualifications and Standards

KRS and Benchmarked Civilian Board Structures

Executive Order 2016-340 expanded the KRS Board to include additional members with financial expertise. The number of appointees with investment experience to be made by the Governor was expanded from two to six, increasing the overall size of the Board from 13 to 17.

As noted previously, our team has benchmarked 20 other state retirement systems in neighboring and/or similarly sized states that will also be used in later reports. Of these 20 benchmark states, nine cover teachers in the same primary retirement system as civilians and other employees, while 11 have separate systems for teachers with a separate governing Board, for which we also collected information. Among the nine states with both civilians and teachers under the same system, neighboring Indiana consolidated the administration of all of its separate systems under a common Board and administration in 2011 (benefits remain separate).

Also among these 20 benchmark states, only four have separate systems for judicial employees (Georgia, Illinois, Iowa, and Michigan), with the remaining 16 states administering retirement programs for the judiciary as a component of their overall, primary system.

We collected the following information for each of these 20 states:

- Overall Board composition and form of appointment
- Whether appointed members are appointed by the executive or legislative branch
- Whether the legislature must consent to executive appointments
- The number of Board members that are required to have financial or investment experience, and the definition of such experience

The following table summarizes the number of appointees for each state's primary retirement system (information regarding teacher-specific systems follows separately), as well as the appointing authorities for Board members. While approaches across these benchmarks vary, many states balance representation across appointees, elected system members, and ex officio members with broader responsibilities within each government.

Retirement System Board	Size	Appointed	Elected	Ex Officio
California Public Employees Retirement System	13	3	6	4
Colorado Public Employees Retirement Association	15	3	11	1
Florida Retirement System	3	1	0	2
Georgia Employees Retirement System	7	4	0	3
Illinois State Employees Retirement System	13	6	6	1
Indiana Public Employees Retirement Fund	9	7	0	2
Iowa Public Employees Retirement System	11	6	0	5
Massachusetts State Employees Retirement System	5	1	2	2
Michigan State Employees' Retirement System	9	4	0	5

Retirement System Board	Size	Appointed	Elected	Ex Officio
Missouri State Employees Retirement System	11	6	3	2
New York State Common Retirement Fund	1	0	0	1
North Carolina Retirement Systems	13	10	0	3
Ohio Public Employees Retirement System	11	2	7	2
Pennsylvania State Employees Retirement Systems	11	10	0	1
South Carolina Retirement Systems	11	11	0	0
Tennessee Consolidated Retirement System	20	9	2	9
Texas Employee Retirement System	7	7	0	0
Virginia Retirement System	9	9	0	0
West Virginia Consolidated Retirement Board	16	12	0	4
Wisconsin Retirement System	13	10	1	1
Average (Excluding Kentucky)	**10**	**6**	**2**	**2**
Median (Excluding Kentucky)	**11**	**6**	**0**	**2**
Kentucky Retirement Systems (2015 and before)	**13**	**6**	**6**	**1**
Kentucky Retirement Systems (2016)	**17**	**10**	**6**	**1**

Source: National Association of State Retirement Administrators data, individual retirement system web sites, and relevant state statutes and code.

On a comparative basis, the current number of KRS appointed and ex officio members is consistent with typical practices, with a somewhat larger number of elected members resulting in an above average Board size overall. To some degree, Board size can be associated with representation for the span of covered members. For example, the largest benchmark plan, the Tennessee Consolidated Retirement System (TCRS), also administers multiple, separate plans including the plan for teachers, and therefore the executive appointments also include representatives of schools and universities. This factor is also reflected in Kentucky's structure, given elected member positions associated with distinct groups of public employees, and the appointed positions nominated by local government associations.

While a slight minority of nine of the other systems provide for direct legislative appointments to the Board, an additional five provide for Senate confirmation of the Governor's nominations. In Indiana the House and Senate provide the Governor with two nominations each, from which the Governor selects appointments. Accordingly, some form of legislative involvement is common. The states that provide for Senate confirmation include states with part-time legislatures. For example, the State of Texas requires the advice and consent of the Senate for the Governor's seven appointments to the Employee Retirement System and nine appointments to the Teacher Retirement System, and overall the Senate must confirm roughly 1,000 appointments, yet it only meets in odd-numbered years. The Governor's appointments may begin serving when appointed on an interim basis, and are then reviewed when the legislature is in session.

TRS and Benchmarked Teacher Board Structures

The Kentucky Teachers Retirement System is similar to the average and median for other teacher systems in total Board size, but is unique among the 10 states reviewed in not having any appointed

members -- all are elected by current or retired members. The average among the benchmarked teacher systems is five appointed members with a median of four.

Teachers Retirement System Board	Board Size	Appointed	Elected	Ex Officio
California State Teachers Retirement System	12	5	3	4
Teachers Retirement System of Georgia	10	8	0	2
Illinois Teachers Retirement System	13	6	6	1
Massachusetts Teachers' Retirement System	7	2	2	3
Michigan Public School Employees' Retirement System	12	11	0	1
Missouri Public Schools Retirement System	7	3	4	0
New York State Teachers' Retirement System	7	2	3	2
Ohio State Teachers Retirement System	11	3	7	1
Pennsylvania School Employees Retirement System	15	2	6	7
Teacher Retirement System of Texas	9	9	0	0
Average (Excluding TRS)	**10**	**5**	**3**	**2**
Median (Excluding TRS)	**10**	**4**	**3**	**1**
Kentucky Teachers Retirement System	9	0	7	2

Source: Review of National Association of State Retirement Administrators data, individual retirement system web sites, and relevant state statutes and code.

The Commissioner of the Kentucky Department of Education is an Ex Officio member of the Kentucky TRS. Since the Education Commissioner is appointed by the state Board of Education, whose members are appointed by the Governor, this might be considered a form of executive appointment, but it is indirect with the Board of Education members and Commissioner holding staggered terms.

Legislative involvement in Board appointments was much less common among the 11 other teacher systems listed in the preceding table than in primary state retirement systems, with only one of the 11 providing a legislative appointment, and four requiring Senate consent to executive appointments.

The Kentucky Judicial Form Retirement System is unlike the majority of the other states reviewed which administer pension benefits for legislators and judges through the same Board that administers benefits for the general state employees and sometimes teachers. Only four of the 20 other states had a separate fiduciary board and retirement system for judges. Several others had separate retirement systems for judges that were still within the purview of a consolidated retirement system board that administers benefits for most state employees. The KJFRS includes appointments by the governor, the legislature, and the state Supreme Court, representing the independently-elected judges, and is therefore the only system that currently involves the legislature in the Board appointment process. There are currently no investment or financial experience requirements for KJFRS Board members.

Board Structure – General Considerations

Academic research on the effect of Board structure on pension plan performance is mixed. Different studies have found somewhat weak and/or inconsistent correlations with investment performance.[8] Faced with such inconclusive research findings, the Manhattan Institute, a free market public policy think-tank, recommended in 2016 that "Reforms should strive for more balance in boards, including requiring public-citizen members and members with financial expertise."[9] In response to this recommendation, the National Association of Retirement System Administrators (NASRA) has highlighted the importance of plan assets to participating members, noting that plan participants are the sole "owners" of such assets once placed in trust.[10]

While such perspectives diverge in some respects, there is a general acknowledgment that the general public, taxpayers, participating employers, and plan participants are all meaningful stakeholders in public retirement systems. In this spirit, the leading professional association for public sector finance officials, the Government Finance Officers Association (GFOA) has issued a best practice on public employee post-employment benefit systems stating:

> *"Board composition should reflect the varied interests of those responsible for funding the plan and should include plan participants and retirees, citizens of the governmental unit, and officers of the plan sponsor, as well as independent directors. This assures balanced deliberations and decision making."*[11]

Board Qualifications

The importance of training and education for all Board members and increased emphasis on financial and investment experience is also highlighted in academic and policy research, professional association guidelines, and the PFM team's practical experience.

Under Kentucky Executive Order 2016-340, new KRS Board investment experience requirements for at least six appointees of the Governor was defined as including:

> *"at least ten (10) years of experience in one (1) of the following areas of expertise:*
>
> *a. A portfolio manager acting in a fiduciary capacity;*
>
> *b. A professional securities analyst or investment consultant;*

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[8] See, for example, Albrecht and Hingorani, *Effects of Governance Practices and Investment Strategies on State and Local Government Pension Fund Financial Performance*, International Journal of Public Administration, Fall 2004; Albrecht, Shamsub, Giannatsio, *Public Pension Fund Governance Practices and Financial Performance*, Journal of Public Budgeting, Accounting & Financial Management, Summery 2007; Mitchell and Hsin *Public Sector Pension Governance and Performance*, The Economics of Pensions: Principles, Policies and International Experience (1997); Useem and Mitchell, *Holders of the Purse Strings: Governance and Performance of Public Retirement Systems*, Social Science Quarterly, Vol 81, 2 (2000); Yang and Mitchell, *Public Sector Pension Governance, Funding and Performance: A Longitudinal Appraisal*, Pension Fund Governance: A Global Perspective on Financial Regulation (2008).

[9] Manhattan Institute, *Safeguarding Public-Pension Systems: A Governance-Based Approach*, March 2016

[10] http://www.nasra.org//Files/Letters/Manhattanresponse1604.pdf

[11] GFOA Best Practice, Governance of Public Employee Post-Retirement Benefits Systems, March 2010

> *c. A current or retired employee or principal of a trust institution, investment or finance organization, or endowment fund acting in an investment-related capacity;*
>
> *d. A chartered financial analyst in good standing as determined by the CFA Institute;*
>
> *e. A university professor who teaches economics or investment-related studies; or*
>
> *f. Any other professional with exceptional experience in the field of public or private finances."*

While investment and financial experience requirements vary among the benchmarked retirement systems, Kentucky's standards are consistent with best practices, and other states nationally have enhanced their requirements in similar fashion. The State of Ohio, for example, added an executive appointment with investment experience requirement for each of its retirement system Boards in 2004, and the State of South Carolina completely restructured its Board, adding a separate investment committee with investment or financial experience required for all members in 2005.

The following tables detail the number of Board members required to have specific financial and/or investment experience across the benchmarked state primary and teacher-specific systems, as well as a summary of the standards for such experience. Although such requirements are not universal, these do represent good practice.

As detailed later, it may also be noted that three of these systems – Massachusetts, South Carolina and Wisconsin – have separate investment fiduciary boards in addition to their administrative Boards, with the fiduciary Board requiring more extensive experience. In addition, Florida and New York have sole or limited fiduciary models, where one to three state officials serve as the trustees.

Retirement System Board (Primary)	# of Board members required to have financial and/ or investment experience	Required experience
Kentucky Retirement Systems	6 of 17	10 years of experience and expertise as either a portfolio manager, professional securities analyst, chartered financial analyst in good standing, university professor who teaches economics or investments, or other exceptional experience in the field of public or private finance
California Public Employees Retirement System	0 of 13	No financial background required by state law; State Treasurer and State Controller serve ex officio
Colorado Public Employees Retirement Association	3 of 15	3 members with significant experience and competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis who are not part of the retirement system

Retirement System Board (Primary)	# of Board members required to have financial and/ or investment experience	Required experience
Florida Retirement System	0 of 3	Florida State Board of Administration is governed by a 3 member Board: Governor, Chief Financial Officer, and the Attorney General. The Board is charged with managing pension funds, including public employees and teachers
Georgia Employee Retirement System	1 of 7	10 years of experience in the investment of moneys and not a member of the state retirement system; Auditor and Treasurer also serve ex officio
Illinois State Employee Retirement System	0 of 13	No financial background required by state law Illinois State Board of Investment (ISBI); Treasurer and Comptroller serve ex officio
Indiana Public Employee Retirement Fund	1 of 9	1 member must have experience in economics, finance, or investments; Auditor and Treasurer serve ex officio
Iowa Public Employees Retirement System	3 of 11	Investment Board of the Iowa Public Retirement System 3 members not participants of the retirement system who have substantial institutional investment experience or substantial institutional financial experience
Massachusetts State Employees Retirement System	0 of 5	No financial background required by state law; Treasurer serves ex officio Pension Reserves Investment Management Board (PRIM) handles investments, and requires 1 member who is a private citizen with an investment business background
Michigan State Employees' Retirement System	0 of 9	No financial background required by state law; Auditor, Treasurer serve ex officio
Missouri State Employees Retirement System	0 of 11	No evidence of financial background required
New York State Common Retirement Fund	0 of 1	The Comptroller manages investment operations of NYCRF with the support of the First Deputy Comptroller, the CIO/Deputy Comptroller for the Division of Pension Investments and Cash Management, and the Counsel to the Comptroller and their professional staff, outside counsel, consultants, and advisory committees

Retirement System Board (Primary)	# of Board members required to have financial and/ or investment experience	Required experience
North Carolina Retirement System	0 of 13	No financial background required by state law; Treasurer serves ex officio
Ohio Public Employee Retirement System	3 of 11	1 member appointed by the treasurer who has direct experience in management, analysis, supervision, or investment of assets; 2 members known as the investment expert members who have direct experience in management, analysis supervision, or investment of assets (1 member appointed by the governor and 1 member appointed jointly by the House of Representatives and President of the Senate The Board will designate a person who is a licensed state retirement officer to be the chief investment officer)
Pennsylvania State Employees Retirement Systems	0 of 11	No financial background required by state law; State Treasurer serves ex officio
South Carolina Retirement Systems	0 of 11	No financial background required by state law, however, investments are handled by a separate agency with experience requirements
Tennessee Consolidated Retirement System	0 of 20	No financial background required by state law; State Treasurer, Commissioner of Finance and Admin, Comptroller of Treasury are members of the Board
Texas Employee Retirement System	0 of 7	3 members appointed with experience in securities investment, pension administration or pension law; 1 member appointed with actuarial qualifications; 1 member appointed with experience in governmental finance
Virginia Retirement System	4 of 9	Gubernatorial appointees: 2 with a min of 5 years of experience in the direct management, analysis, supervision, or investment of assets (one state and one faculty or higher education employee); Legislative appointees: 2 with min of 5 years of experience in the direct management, analysis, supervision, or investment of assets (one state employee and one teacher)

Retirement System Board (Primary)	# of Board members required to have financial and/ or investment experience	Required experience
West Virginia Consolidated Retirement Board	8 of 16	All 8 appointees to the Board shall have recognized competence or significant experience in pension management or administration, actuarial analysis, institutional management or accounting; Assets are managed by the State Investment Management Board
Wisconsin Retirement System	0 of 13	No financial background for Board members required by state law; Separate Wisconsin Investment Board oversees investments, and requires that 5 of its 8 members have at least 10 years of investment experience, with any person having financial interest in or whose employer is dealer/broker/securities/mortgage/real estate investments not eligible for appointment, and any member who acquires interest to vacate membership

As detailed in the following table, five of the teacher-specific systems reviewed require investment or financial experience for a minimum number of Board members.

Retirement System Board (Teachers)	Board members required to have financial management or investment experience	Required experience
Kentucky Teachers Retirement System	0 of 9	No financial background required by law
California State Teachers Retirement System	0 of 12	No financial background required by law; Director of Finance, State Controller, State Treasurer serve ex officio
Georgia Teachers Retirement System	1 of 10	1 member with investment experience and not a member of the Teachers Retirement System
Illinois Teachers' Retirement System	0 of 13	No financial background required by law
Massachusetts Teachers Retirement Board	0 of 7	No financial background required by state law; Treasurer, Auditor serve ex officio; Pension Reserves Investment Management Board (PRIM) requires 1 member who is a private citizen with an investment business background

<table>
<tr><td>Michigan Public School Employees Retirement System</td><td>3 of 12</td><td>1 member who is working in a school system in a finance or operations management position who is not a superintendent; 1 retiree from a finance or operations management position; 1 member from the general public who has experience in institutional investments</td></tr>
<tr><td>Missouri Teacher and School Employee Retirement System</td><td>0 of 7</td><td>No evidence of financial background required</td></tr>
<tr><td>New York State Teachers' Retirement System</td><td>3 of 7</td><td>2 members with experience in the fields of finance and investment, at least one must have experience as an executive of an insurance company; one present/former bank executive; state comptroller designee</td></tr>
<tr><td>Ohio State Teachers Retirement System</td><td>4 of 11</td><td>A superintendent, treasurer, and 2 members with direct experience in management, analysis, supervision or investment of assets</td></tr>
<tr><td>Pennsylvania Public School Employees' Retirement System</td><td>0 of 15</td><td>No financial background required by state law;
State Treasurer serves ex officio</td></tr>
<tr><th>Retirement System Board (Teachers)</th><th>Board members required to have financial management or investment experience</th><th>Required experience</th></tr>
<tr><td>Texas Teacher Retirement System</td><td>3 of 9</td><td>TX Gov Code 825.002(b) requires that the Governor shall appoint 3 members of the Board who have demonstrated financial expertise, who have worked in private business or industry, and who have broad investment experience, preferably in investment of pension funds. None of these members appointed may be a member or annuitant of the retirement system.</td></tr>
</table>

An Alternative Structure -- Separate Investment Boards

As noted previously, an alternative to the standard of having one overarching Board responsible for both plan administration and investments is to have a separate investment Board that may have different membership than the system's primary Board. This structure is designed to provide greater focus on investment decisions with enhanced reliance on independent expertise. Examples include the following:

- The State of Wisconsin has created a state Investment Board to manage investments for the Wisconsin Retirement System, State Investment Fund, and several other smaller trust funds. Five out of eight members are required to meet specific minimum investment or financial criteria. Two of the remaining members must be participants of the Wisconsin Retirement System and are appointed by the retirement Board.

- For the Florida Retirement System three-person Board of Administration, the Governor, the state Chief Financial Officer, and Attorney General, all elected positions, appoint three members each to a separate Investment Advisory Council, although the fiduciary responsibility for decisions remains with the Board.
- In 2005, South Carolina established the South Carolina Retirement System Investment Commission (RSIC) and transferred fiduciary responsibility for investments from the Retirement System Board to the RSIC, which includes seven members appointed by the Governor, legislature, Comptroller General, and several other ex officio and elected members. All must meet investment or financial experience criteria.
- In Massachusetts the Pension Reserves Investment Management (PRIM) Board manages investments for all state pension funds. The state Treasurer chairs the Board and the Governor appoints a member who is required to have investment experience.

Unlike the KRS, the TRS does not have a requirement for financial or investment expertise among Board members. In a modified version of the separate investment Board structure, however, the TRS does include the non-voting participation of two outside investment experts on its Investment Committee. This structure was implemented by the TRS Board in December 2008 following a Public Pension Working Group process, and features parallel experience requirements to those in Executive Order 2016-340. To date, this practice has not been incorporated into statute.

General Board Education and Training

The importance of education and training for all retirement system Board members is emphasized by several best practices on system governance. For example, the GFOA best practice previously referenced also states:

> *"New trustees must receive orientation training explaining their responsibilities and fiduciary duties as well as the duties of the system's staff and agents (e.g., actuaries, attorneys, advisors, and fund managers). A program of continuing education must be developed, and participation should be strongly encouraged or required."*

Similarly, the National Conference of Public Employee Retirement Systems (NCPERS) recommends the "Adoption of a fiduciary education program to continuously improve fiduciaries' skill sets."[12]

KRS and TRS have both adopted education policies for Board members in order to ensure members are adequately equipped to serve in their role as fiduciaries . The KRS policy requires that new Board members undergo a minimum of eight hours of trustee education within the first three months of service, and a minimum of 12 hours of trustee educational activity in each year thereafter. The TRS policy requires a minimum of four hours of trustee education within the first two months of service, and a minimum of eight in each year thereafter.

Although there is no generally accepted national best practice for the specific number of hours of trustee training to be required on an annual basis, Kentucky's systems should continue to maintain and monitor their education programs to ensure meaningful training opportunities for Board members.

[12] NCPERS Best Governance Practices for Public Employee Retirement Systems, March 2012

Staffing the Systems within the State Personnel System

Executive Order 2016-340 also requires that all KRS employees except for the Executive Director shall be fully subject to the state personnel system established pursuant to KRS 18A.005 to 18A.204, including determination of salaries, effectively placing investment professionals and all other KRS employees within the state personnel system. This approach provides structure to retirement system staffing that can be beneficial for most positions, including those in customer service, general administration and support, and non-investment professional roles.

At the same time, our team's experience and other industry research[13] indicates that greater recruitment and retention flexibility is warranted for senior professionals in the highly specialized and competitive investment management field with responsibility for overseeing billions of dollars in assets. Attempts to supplement insufficient internal expertise and capacity can lead to a higher level of external investment management and significantly higher costs.

To ensure appropriate staff qualifications and compensation, active Board review of any senior-level compensation outside of the state personnel system would be critical, particularly if bonuses are used.

Initial Governance Recommendations

- Establish balanced retirement system governance consistent with best practices for diverse representation by including Board members with investment experience, stakeholder appointments (i.e., continued nominations from local government associations for the KRS Board), and elected members.
- For the KRS Board, institutionalize stronger investment expertise requirements by amending current statutes to reflect Executive Order 2016-340 increasing the number of executive appointments with investment experience requirements from two to six. This will provide improved oversight and stability for the KRS Investment Committee, be consistent with benchmark norms for the total number of appointed trustees, and provide some of the benefits of a separate investment Board model within a more traditional integrated administrative/fiduciary Board structure.
- Add Senate confirmation of the Governor's appointments to the KRS legislation, as 2016 Senate Bill 2 (2016 SB2) has previously contemplated. Common among the benchmarked systems, this approach provides a further check-and-balance on the governance structure across Administrations that could help to sustain improved oversight over time.
- In addition, 2016 SB2 contemplated adding six appointments by the Governor to the TRS Board, with parallel Senate confirmation, and a requirement that two of the appointments have investment experience. While the TRS Board has performed relatively well in many respects, Kentucky is an outlier with regard to the lack of stakeholder diversity and exclusive concentration of elected members on its teachers retirement system Board. To ensure a full range of stakeholder perspectives and appropriate Board expertise for the long-term, we recommend adoption of this approach or a similar set of requirements.

[13] Funston Advisory Services LLC, *Public Pension Governance That Works*, March 2014

- Adding the investment experience requirement for the two appointments by the Governor to the KJFRS Board would be consistent with the spirit of Executive Order 2016-340 and 2016 SB2. The present composition of the Board provides that the legislators and judges have a majority on their respective investment committees. Increasing the number of executive appointments would shift this balance, but simply requiring the two executive appointments to have investment experience would retain the current balance while ensuring financial and investment expertise on the Board.
- As an alternative governance approach, the Commonwealth could consider establishing a separate Investment Board to serve all three retirement systems with consistent, high-level investment expertise, experience, and responsibility.
- Under Executive Order 2016-340, the placement of KRS employees under the state personnel system provides a range of benefits, and is generally good policy. For senior investment professionals, however, we recommend that the Commonwealth consider providing exemptions or other flexibility to ensure the capacity to recruit, retain, and quickly replace as needed high-caliber, specialized personnel.

As noted previously, this initial report is focused substantially on a review of the issues addressed in Executive Order 2016-340 and 2016 SB 2. In subsequent reports, we will address additional governance concerns, such as the options for administering the County Employees Retirement System (CERS), now a component of the KRS which some stakeholders have proposed to become a separate, fully independent system.

Appendices

Making State Pension Investments More Transparent

Accountability varies widely and could be improved

Overview

The California Public Employees' Retirement System (CalPERS), the nation's largest public retirement plan, recently raised the bar on investment fee transparency by disclosing the full amount it pays to invest in private equity, which may bring greater rewards but also greater risk and higher management costs. CalPERS, like most public retirement systems, pays performance-based fees, known as carried interest, to external investment managers as part of their compensation, but the system only began publicly disclosing these costs in November. CalPERS' new policy of reporting carried interest and other performance fees resulted in the disclosure that external investment partners realized $700 million from profit sharing agreements in fiscal 2015.

The move highlights the widespread problem among public retirement systems of underreported manager fees and expenses, particularly those associated with alternative investments such as private equity, real estate, and hedge funds, and points to the need for greater disclosure in order to provide full transparency on investment costs. State retirement systems receive guidance on disclosing investment details from the Governmental Accounting Standards Board and the Government Finance Officers Association's Best Practice for Public Employee Retirement System Investments. However, states interpret and implement these standards differently.

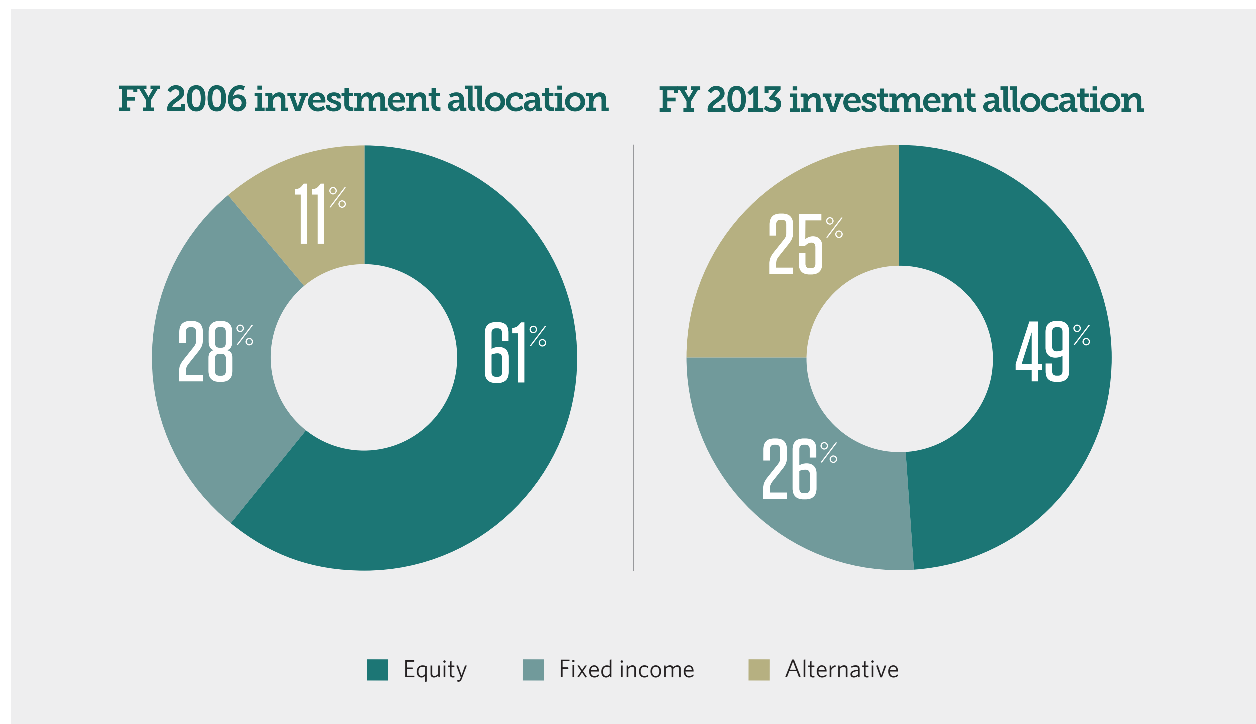
To examine transparency practices across the 50 states, The Pew Charitable Trusts collected data on asset allocation, performance, and fees from the 73 largest state-sponsored pension funds. Collectively, these funds have approximately $2.9 trillion in investments, or more than 95 percent of all state pension fund investments, according to the U.S. Census Bureau's Census of Governments 2014 report on state-administered pensions.[1]

The analysis shows wide variation in investment strategies, policies on disclosure of investment returns, and transparency in reporting the costs of managing assets. Better and more consistent disclosure rules would help those with a stake in these systems discern how well investments are being managed and provide data that could be compared more easily from state to state.

In many cases, current disclosure policies make it difficult for policymakers, stakeholders, and the public to gauge the actual performance of these funds. To help interested parties develop a more complete understanding of both the results and the costs of different investment strategies, this brief highlights some specific steps to improve transparency through greater disclosure. States and funds should:

- Adopt comprehensive fee-reporting standards, such as those proposed by the Institutional Limited Partners Association's Fee Transparency Initiative.
- Make investment policy statements transparent and accessible.
- Disclose bottom-line performance, both net and gross of fees.
- Expand reporting to include longer-term performance results.
- Report results by asset class, net and gross of fees.

Figure 1
Allocation of Fund Assets in FY 2006 and 2013
Percentage in alternative investments more than doubled



Sources: State Comprehensive Annual Financial Reports, 2006 and 2013

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Increased use of alternative asset classes requires greater disclosure

State retirement systems across the United States collectively have more than $3 trillion in assets, with three-quarters invested in stocks and what are known as "alternative investments"—an allocation that has more than doubled in recent years.[2] To manage these assets, state funds paid more than $10 billion in 2014 in fees and investment expenses—their largest expenditure. The cost of managing these assets has increased by more than 30 percent over the past decade, a jump closely correlated with greater use of alternative investments, such as real estate, private equity, and hedge funds. These fees can reduce investment returns on alternatives by as much as 10 to 20 percent.

What Are Alternative Investments?

Although there is no fixed definition for alternative investments, they are generally agreed to include private equity, hedge funds, real estate and some commodities. These investments typically lack an established public exchange, have low liquidity, and can be more difficult to value. Alternative investments typically carry higher fees and can be employed to diversify investment portfolios or to achieve higher rates of return, although often at higher levels of risk.

Some state funds report investment performance "gross of fees," which does not account for payments to investment managers. Some provide information about overall long-term performance but do not detail the results of individual investment strategies. Some states, though, are taking action to improve transparency. After public criticism, state treasurers in North Carolina and Rhode Island took new steps over the past two years toward greater fee disclosure.[3]

Cities face similar issues. For example, a study of the New York City pension fund released in 2015 found that the fund underperformed its stated investment goals by a total of $2.5 billion over the past decade, largely as a result of high investment fees, and the Dallas Police and Fire Fund recently reported significant losses in investments made in local real estate.[4]

These examples all point to the need for greater and more consistent transparency on these investments. In particular, the increased use of alternative asset classes requires greater disclosure because of their complicated nature, intricate fee structures, and potential risk to a fund's health.

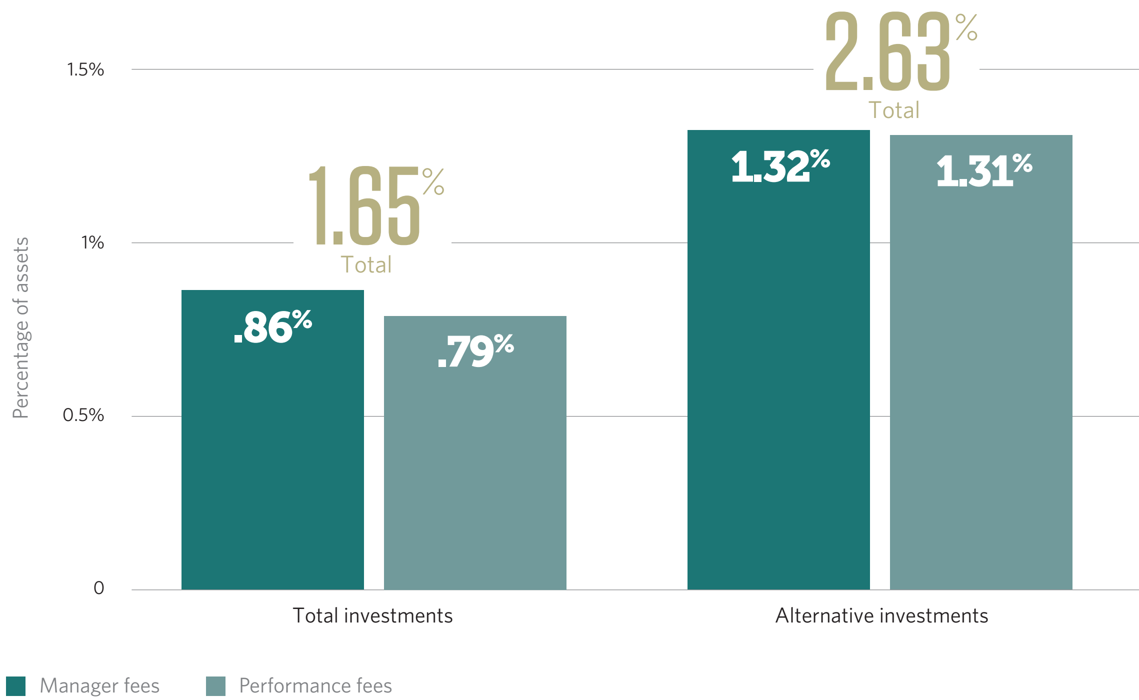
Recommendation 1: Adopt comprehensive fee reporting standards

A recent report by CEM Benchmarking Inc., an independent global provider of comparative analysis for large pension funds, endowments, and sovereign wealth funds, estimates that the average value of undisclosed private equity fees, including carried interest, monitoring costs and other portfolio company fees, can equal 1.5 percent or more of assets each year, or about half of total private equity management costs.[5] The recently released 2014 CalPERS reporting mirrors this finding and suggests that the treatment of carried interest is a significant contributor to the wide variation in reported fees across the 73 plans studied here.

Figure 2

MOSERS' Investment Fees Paid to External Managers, 2013

Performance fees represent close to half of all reported fees



Source: 2013 Comprehensive Annual Financial Report, Missouri State Employees' Retirement System

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For example, the South Carolina Retirement System holds 38 percent of its assets in alternative investments and has been widely criticized for being subject to some of the highest fees in the country—1.58 percent in reported fees in 2013. But CEM found that South Carolina was "simply reporting more costs than other funds rather than incurring more costs."[6] The South Carolina Retirement System Investment Commission (RSIC) reports invoiced management fees, which is common; but unlike most funds, it also reports the fees deducted from returns. The commission explains its practice with this note:

> A portion of investment expenses are directly invoiced by the manager; however, a significant number of investment managers provide account valuations on a net of fee basis. Since these investment expenses are netted against investment income, amounts reported represent a good faith attempt by the RSIC to disaggregate amounts that were not necessarily readily separable throughout the fiscal year. The collection process is not standard practice for many investment managers. The investment expense numbers netted out of accounts include amounts for investment management fees, performance fees (carried interest) and other expenses such as organization expenses in limited partnership structures."[7]

In other words, rather than relying on the external managers' standard reporting or invoices, South Carolina collects and validates additional detailed information, not only on full management fees but also on portfolio company fees, other fund-level fees, and accrued carried interest (performance fees). This is an attempt to account for all fees incurred during the fiscal year, including those that were netted from asset values.[8]

This level of fee disclosure may be uncommon, but South Carolina is not the only plan collecting and reporting more than invoiced fees. The Missouri State Employees' Retirement System (MOSERS) is particularly thorough in collecting and reporting these fees, not only by asset class but for each external consultant or manager. MOSERS reports the highest fees of the 73 plans studied, at 1.73 percent, with 1.65 percent paid to external managers. But, as illustrated in Figure 2, about half of all reported external management costs during the 2013 reporting period were performance fees that many states do not report.

The call for standardized reporting and transparency of private equity fees in the United States may be gaining momentum. The Institutional Limited Partners Association's Fee Transparency Initiative, a widely supported industry effort to establish comprehensive standards for fee and expense reporting among institutional investors and fund managers, is advocating for total fee reporting by private equity managers and their investors.[9] The association released a final version of the proposed standardized reporting template in January 2016.[10] Further, in a recent letter to the Securities and Exchange Commission, 13 state and municipal treasurers and comptrollers—including several contributors to the Fee Transparency Initiative—made an appeal for industrywide standards on private equity fee disclosure, including carried interest.[11]

> Clear information that accounts for the costs of managing assets is needed to fully understand investment performance. Still, more than one-third of plans examined do not disclose detailed returns minus the fees paid to managers, or "net of fees."

Recommendation 2: Make investment policy statements transparent and accessible

The Government Finance Officers Association (GFOA) recommends that each pension plan develop a concrete statement of investment goals that describes its investment and risk tolerance saying, "The development of an investment policy is fundamental to sound financial management."[12] Public pension funds' formal investment policies include information on the risk and return objectives, as well as targets for investments across different asset classes. Making these investment policies transparent and readily accessible provides stakeholders with critical information on the strategies that pension systems follow for the investment of public funds.

For example, MOSERS provides online access to its investment policy statement, which includes a detailed description of the use of alternative investments to achieve the fund's risk and return objectives. The system also includes an in-depth explanation of the policy in its annual reports.[13]

Of the 73 plans examined, 59 provided access to investment policies online; others indicated that their policies are available upon written request. Setting a standard of making these statements available online, following the practice of most funds, creates the foundation for transparency in public pension investing.

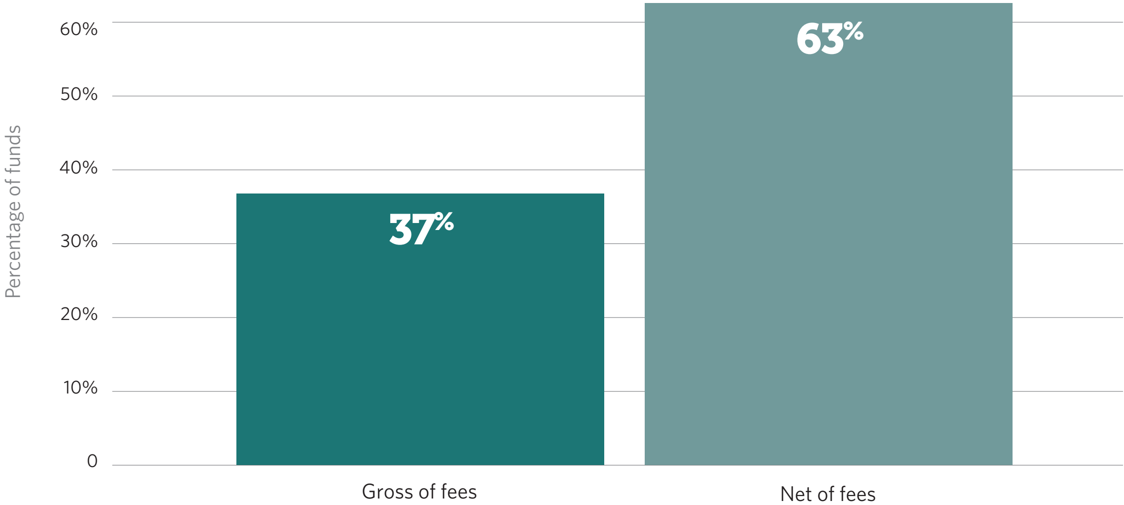
Recommendation 3: Disclose bottom-line performance, both net and gross of fees

Clear information that accounts for the costs of managing assets is needed to fully understand investment performance. Still, more than one-third of plans examined do not disclose detailed returns minus the fees paid to managers, or "net of fees." For 10-year results, 27 of 73 plans studied, or 37 percent, reported returns "gross of fees"—without deducting manager fees. (See Figure 3.) Reporting performance both gross and net of fees gives stakeholders information on both the cost and bottom-line results of pension funds' investment strategies. A direct comparison of returns on a net and gross basis is a clear and easy method for examining the impact of fees on fund performance.

Figure 3

State Pension Fund Performance: Gross or Net of Fees

Most plans report totals minus fees



Sources: State Comprehensive Annual Financial Reports, 2013 and 2014; state treasury reports; quarterly investment reports; and state responses to data inquiries

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Recommendation 4: Expand performance reporting to include 20-year results by investment type

Fund investment policies are designed to reflect the long-term nature of pension funds because many participants may work for over 30 years and receive benefits for 20 years—or more—in retirement. However, the GFOA recommendations only call for reporting performance over five years, and most funds report only 10-year investment performance.

Reporting results over a longer time horizon would supply stakeholders with information that is better aligned with fund investment strategies. It also would be helpful when examining the impact of shorter-term results, such as the strong performance during the 1990s bull run of the stock market or the underperformance to fund benchmarks during the volatile financial markets of the 2000s. Based on Pew's research, 13 of the funds in the analysis regularly provide 20-year investment performance figures in their reports and six report such figures by asset class. Making this practice routine would furnish stakeholders with critical information on long-term results that is more aligned with the long-term investment strategies that these funds follow.

Recommendation 5: Include performance results by asset class—both net and gross of fees

The GFOA recommendations call for funds to provide performance results by asset class over time, as well as full disclosure of long-term investment performance by investment type or asset class. State retirement systems in Georgia, Kentucky, Louisiana, Missouri, and New York already release comprehensive 20-year data on performance returns by asset class. Currently, only Georgia and Missouri make that information available net of fees. South Dakota is the only state to disclose 20-year performance net and gross of fees but does not break this reporting down by asset class.

While the performance of individual asset classes may vary over the short term, long-term performance data must be available to assess the overall success of the investment strategy. Further, disclosure of performance both gross and net of fees by asset class would provide stakeholders with bottom-line results and a clearer picture of the cost of implementing the investment strategy identified in fund policy. (See Appendix A for an illustration of how the current reporting for the Pennsylvania Public School Employees' Retirement System could be improved to include this additional information.)

Figure 4

Most States Report Pension Investment Performance After Fees

In some states reporting practices differ by plans

Gross of fees | Net of fees | Multiple

Notes: South Dakota discloses performance as both net and gross of fees. The states marked as having multiple reporting methods have two funds included in our 73 list that report performance differently from each other.

Sources: State Comprehensive Annual Financial Reports, 2013 and 2014; state treasury reports; quarterly investment reports; and state responses to data inquiries

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Conclusion

Allocation of assets and bottom-line performance ultimately determine plans' fiscal health and the ability to pay for the promised retirement benefits; in fact, experts estimate that investment returns account for 60 percent of pension benefits. The fees and cost of managing these assets can significantly affect the long-term costs of providing retirement benefits to public workers.

There is no one-size-fits-all approach to investing pension assets. However, because many alternative investments involve greater risk and complexity, boosting transparency is essential. Policymakers, stakeholders, and the public need full disclosure on investment performance and fees to ensure that risks, returns, and costs are balanced in ways that follow best practices and meet funds' policy needs.

Methodology

Pew's research focused on financial data collected from 2012, 2013, and 2014 financial reports, including Comprehensive Annual Financial Reports, investment reports, and in two instances—North Carolina and Connecticut—annual state treasury reports. For each plan, Pew collected data from the financial reports on asset allocation, performance, and fees. Pew made no adjustments or changes to the state figures and offered states the opportunity to verify the data. A forthcoming report on pension fund investments and performance will examine plan level 2014 data.

Additional data used in this analysis came from two sources:

- Data collected from state Comprehensive Annual Financial Reports; pension plan actuarial valuations; and other statements that disclose financial details about individual public pension plans between fiscal 1992 and 2014. In some cases in which information was not available in public sources, the data also include facts provided by the individual pension plans in response to Pew's requests.
- *Pensions & Investments'* "Public 100,"[14] a fund-level data set that provides details on public-sector pension plans' use of hedge funds, private equity, and other alternative investments. This source includes data from 126 major state and local pension funds covering 95 percent of all U.S. public pension assets, according to U.S. census data. Pew's analysis used the data set covering 2006 to 2013, the most recent period for which consistent data on asset allocation and fees are available. In particular, the analysis relied on the data for the period between 2006 and 2011.

It is important to note that available data sources should be used with care when making cross-plan comparisons. For example, inconsistencies often arise in reporting periods and asset classification across funds. In addition, the annual reports of the public pension plans studied show a wide range of completeness in disclosure of fees paid, particularly with regard to alternative classes such as hedge funds and private equity.

Appendix A

Pennsylvania Public School Employees' Retirement System (PSERS) Disclosure

PSERS does a good job of reporting on fund performance and providing returns net of fees by asset class for one, three, five, and 10 years. The system also provides relevant benchmarks for each of these breakdowns. The table below displays these performance data but also illustrates how our recommended improvements to reporting could be incorporated. Specifically, the net-of-fees performance information would be supplemented by the addition of gross-of-fees figures on the left that easily highlight the impact of fees on the fund's returns, and 20-year information is added to show long-term performance results.

	Gross of fees					Net of fees				
	1 year	3 years	5 years	10 years	20 years	1 year	3 years	5 years	10 years	20 years
PSERS Total Portfolio						14.91	8.66	12.09	7.28	
Total Fund Policy Index						12.05	6.14	9.2	5.81	
Median Public Defined Benefit Plan (DBP) Fund Universe (HEK Database)						16.56	9.57	12.44	6.86	
PSERS U.S. Equity Portfolios						25.27	16.52	19.95	7.99	
U.S. Equity Policy Index						24.55	15.77	18.73	8.07	
PSERS Non-U.S. Equity Portfolios						18.14	6.01	12.32	9.2	
Non-U.S. Equity Policy Index						21.1	5.54	11.29	8.2	
PSERS Fixed Income Portfolios						9.86	7.21	10.71	7.46	
Fixed Income Policy Index						6.52	4.34	7.83	6.5	
PSERS Commodity Portfolios						13.12	-4.59	3.94	N/A	
Commodity Policy Index						8.21	-5.16	1.99	N/A	
PSERS Absolute Return Portfolios						6.31	4.33	8.24	N/A	
Absolute Return Policy Index						7.5	7.5	7.7	N/A	
PSERS Risk Parity Portfolios						23.95	12.95	N/A	N/A	
Risk Parity Policy Index						16.45	4.23	N/A	N/A	
PSERS Master Limited Partnership (MLP) Portfolios						35.97	28.46	33.01	N/A	
Standard & Poor's MLP Index						24.87	20.32	26.99	N/A	
PSERS Real Estate						16.44	10.91	7.9	6.06	
Blended Real Estate Index						11.13	10.21	8.75	8.63	
PSERS Alternative Investments						14.27	11.33	14.9	13.7	
Thomson ONE Median Return, Vintage Year Weighted						8.34	5.14	7.6	5.78	

Currently undisclosed

Source: Pennsylvania Comprehensive Annual Financial Report, 2014

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Endnotes

1 2014 Survey of Public Pensions: State and Local Data," U.S. Census Bureau (February 2015), http://www.census.gov/govs/retire/.

2 2014 Survey of Public Pensions:State and Local Data," U.S. Census Bureau (February 2015), http://www.census.gov/govs/retire/; all other figures are calculated using Pew data.

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6 Dang, Dupont, and Heale.

7 South Carolina Retirement Systems, "FY2013 Comprehensive Annual Financial Report," 85–89, https://www.retirement.sc.gov/financial/cafrarchive/CAFR%202013.pdf.

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9 Institutional Limited Partners Association, "Private Equity Reporting Should Be More Uniform Across Industry, Says ILPA," Sept. 3, 2015, http://ilpa.org/index.php?file=/wp-content/uploads/2015/09/ILPA-Transparency-Initiative-press-release_2015-Sept3.pdf&ref=http://ilpa.org/2015/ilpa-publishes-a-press-release-on-increasing-transparency-in-the-pe-industry/&t=1447791502.

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14 *Public 100*," Pensions & Investments, http://www.pionline.com/data-store.

For further information, please visit:

pewtrusts.org/pensions

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Project website: pewtrusts.org/pensions

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Institutional Limited Partners Association (ILPA) Fee Transparency Initiative Template

Reporting Template

ILPA Reporting Template (v. 1.1) - This packet was last updated on Oct. 17, 2016

Overview

The ILPA Reporting Template (the “Template”) was developed to promote more uniform reporting practices in the private equity industry. It is one component of the ILPA's Transparency Initiative (the “Initiative”), a broad-based effort to establish more robust and consistent standards for fee reporting and compliance among investors, fund managers, and their advisors. The Initiative was comprised of senior investment and reporting professionals from a cross-section of investor institutions and advisors.

The Template, which details all monies paid to the fund manager, affiliates, and third parties, is the first deliverable of the Initiative. The Template reflects feedback from more than 120 individuals and organizations, including nearly 50 global LP groups, and 25 General Partner organizations (GPs), as well as numerous industry trade bodies and a number of leading consultants, advisors, fund administrators, and accountants.

Template Goals

The Template is organized into two sections (A & B). Each section has a discrete goal, providing LPs with:

A. The ability to monitor, aggregate and analyze an LP’s direct costs of participating in a given private equity fund (a “Fund”). These values are presented within the framework of a typical partners’ capital account statement, providing valuable context to the reported

B. A summary of the GP’s sources of economics regarding the Fund and the investments made by the Fund (including reimbursements and any fees not subject to offset).

Template Guidance

Through dozens of interactions with the GP and LP communities during the consultation phase of the Template’s development, the ILPA became aware of several complex issues that should be considered by all stakeholders when populating and analyzing the content provided in the Template. The guidance below is intended to communicate the expectations and necessary background to allow LPs and GPs to determine how both parties can utilize the Template most effectively.

This guidance assumes that every LP and GP has unique needs and resources. To accommodate this diversity, the responsibility for determining how the Template can be used to support their needs lies with individual LPs and their managers. The ILPA recommends that LPs and GPs should carefully consider the following when deciding how the Template is to be utilized within a GP’s periodic disclosure package.

These guidelines, originally issued in January 2016, and revised in October 2016, are not anticipated to change in the near term. However, the ILPA will continue to monitor the challenges faced by LPs and GPs during the Template’s adoption and may make additional clarifying or other changes to either this guidance or the Template in future. Interested parties should consult ilpa.org for the latest versions of these guidelines and the Template.

I. Frequency & Implementation

The Template is designed to be supplemental to a Fund’s standard financial disclosures. The ILPA recommends that the Template is provided on a quarterly basis within a reasonable timeframe after the release of standard reports. The Template is not intended to be a substitute for any other reports, including capital call and distribution notices.

The content should be provided in an Excel or digital format (e.g., XML) that is compatible with reporting software systems and allows for aggregation and analysis of information. To maximize the usefulness of the data being presented, PDF format is not recommended.

During the initial adoption period, LPs should adjust their adoption/frequency/ lagging expectations to accommodate for the necessary changes to GPs’ processes, technology, and resources. It is expected to take up to one year or more for GPs to adapt their processes to meet the demands of mass-producing the customized Template for each of their LPs, depending on the size, complexity, and infrastructure of each firm’s operations.

The ILPA anticipates that the timing of each GP’s transition to the standard indicated by the Template will depend upon the point at which a critical mass of a GP’s LPs begin requesting the Template. Therefore, it’s imperative for LPs to signal to their GPs at the earliest opportunity that they require this information.

Additionally, LPs should be aware that select fields within the Template, particularly in Section A.3 (“Miscellaneous”), may be more difficult for GPs to produce. Feedback from GPs suggest that the data in Section A.3 is neither customarily tracked in most GP systems, nor easily derived from existing ledger entries. LPs should moderate their expectations for the timely reporting of information for these fields accordingly. For the avoidance of doubt, it is anticipated that GPs will eventually modify their processes to allow for the regular reporting of this data in the future.

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When contemplating the desired timeline for full integration of the Template into reporting processes, LPs are reminded that many (if not all) of the fees charged to portfolio investments are tracked in a separate ledger (and software) from a Fund's accounts. It will likely require meaningful revisions to GP accounting and reporting procedures to aggregate the information from multiple ledgers into a single report. The scope of these changes in procedure and operations will necessarily be greater for GPs managing multiple products or pools of capital, those with more complex economic or operating models, or those GPs with a less sophisticated reporting infrastructure.

The Template should only be applied on a prospective basis to future funds, and, where feasible, to current vintages in the active investment phase. See Section IV for additional guidance on legacy funds.

The Template was developed for quarterly frequency to accommodate for LPs' fiscal year ends that often differ from the calendar year reporting of typical GPs. Having the Template data on a quarterly basis allows LPs to produce annualized figures to whatever quarter aligns with their own reporting cycle. However, as improvements in GP reporting processes and reporting software make quarterly calculations more feasible on an automated basis, the ILPA anticipates that GPs and LPs will together determine the frequency that meets each LP's needs.

The ILPA believes that it will be in the best interests of the industry in the long term to explore how to automate the generation, presentation, and dissemination of the data contained within the Template. To that end, the ILPA has collaborated with the AltExchange Alliance to ensure that the elements of the Template are reflected within the AltExchange data standards. A version of the Template is now available in a software-agnostic format (i.e., XML) to facilitate the integration of the Template's elements into LPs' and GPs' existing reporting systems. The XML formatted Template is available on ilpa.org.

II. Tiered Content – Differentiated Levels of Reporting

To ensure the Template focuses on efficiently meeting the needs of a diverse LP community, a two-tiered structure has been incorporated into the Template. Level 1 data represents high-level summary content, and the minimum baseline that the ILPA is recommending should be provided by GPs to LPs. Level 2 data introduces additional granularity and itemization for certain subtotals, i.e., fees subject to offset and partnership expenses, and fees/reimbursements received from portfolio investments. The more-detailed Level 2 content is represented by the shaded, collapsible rows in the Template.

The following table highlights the key differences between the data points captured by Level 1 and Level 2 information in the Template.

Level 1 Standard	Level 2 Standard
Partnership Expenses - Total	Partnership Expenses – Accounting, Administration & IT
	Partnership Expenses – Audit & Tax Preparatory
	Partnership Expenses – Bank Fees
	Partnership Expenses – Custody Fees
	Partnership Expenses – Due Diligence
	Partnership Expenses – Legal
	Partnership Expenses – Organization Costs
	Partnership Expenses – Other Travel & Entertainment
	Partnership Expenses – Other
Total Offsets to Fees & Expenses (applied during period)	Advisory Fee Offset
	Broken Deal Fee Offset
	Transaction & Deal Fee Offset
	Directors Fee Offset
	Monitoring Fee Offset
	Capital Markets Fee Offset
	Organization Cost Offset
	Placement Fee Offset
	Other Offset
Total Fees with Respect to Portfolio Companies/Investments	Advisory Fees
	Broken Deal Fees
	Transaction & Deal Fees
	Directors Fees
	Monitoring Fees
	Capital Markets Fees
	Other Fees

The data representing the Level 1 summary content may be sufficient for many LPs to monitor their portfolios. As such, LPs preferring less detail may request that their GPs provide only Level 1 content. This will help GPs focus their efforts on providing Level 2 content only to LPs that require it.

For the avoidance of doubt, ILPA recommends that GPs provide both Level 1 and Level 2 content to each of their LPs. However, GPs should have conversations with their LPs regarding the requisite level of reporting.

III. Scaled Implementation – Fund Sizes

LPs should factor the size, back-office resources, operating budgets, and complexity of the funds managed by their GPs when determining their requirements for Template compliance.

Some GPs, including newer managers and managers of smaller, VC, or SBIC funds, may not have the staffing or technology resources to populate the quarterly Template in a reasonable timeframe, without significantly reducing their effectiveness in other areas. In addition, several of the fields within the Template may not apply to funds with simpler economics, meaning that these fields would consistently have a null value. LPs' expected timeline for receiving the Template should reflect the operational and other constraints facing GPs described in this section. The ILPA recommends that LPs investing in smaller GPs with simpler economics consider whether Level 1 content would be sufficient to meet their compliance or investment monitoring needs.

IV. Application to Legacy Funds

LPs should consider a fund's age when determining their requirements for Template compliance. The process surrounding how a GP manages account balances or cash flows with respect to certain elements within the Template may make populating the Template difficult. For instance, information may be managed across different ledgers, or GPs may use a different hierarchy for tracking partnership expense sub-totals (audit, bank fees, etc.). There may be a significant operational burden associated with reorganizing a GP's historical ledgers to align with the Template layout. LPs should therefore weigh carefully whether the incremental value of this information for historical periods warrants requiring it for older funds and perhaps consider the acceptability of less stringent requirements (particularly any requests for since inception data).

For the avoidance of doubt, GPs are encouraged to utilize best judgement when an LP requests since inception data for a legacy fund. GPs that deem such requests unduly burdensome for their back-office resources would still comply with these guidelines if they elected not to comply with such a request.

V. Conformity with the LPA

The values presented in the Template should be calculated within the framework of a Fund's Limited Partnership Agreement (LPA), including its valuation policy. Template values for NAV, incentive allocation (carried interest), fee offsets, management fees, unfunded commitment, and call/distribution amounts should be consistent with the totals presented in a Fund's other disclosures. Additionally, the definition used for Related Parties in the Template should be consistent with the definition used in the existing LPA.

Please note that the Template does provide a recommended definition for Related Parties. The ILPA encourages the adoption of this definition for all future PE funds.

As an exception to the above, the ILPA recommends that GPs adopt the ILPA's prescribed hierarchy for partnership expenses, fee offsets and fee/expense income received from investments (all of which is categorized as Level 2 content). Due to the various hierarchies currently being reported in fund financials, LPs are unable to conduct any meaningful, plan-level analysis of these balances. As noted in a previous section, this accommodation is only recommended for newer funds. For the avoidance of doubt, GPs are asked to adopt these categories for reporting purposes only, and are not being asked to revise their methodologies for calculating these sub-totals.

VI. Use of Estimates for Individual Partner's Balances

To provide context to each value, the Template requests an individual LP's allocation for every reported balance. The ILPA acknowledges that it may be unfeasible to precisely calculate the partner's share for certain balances, particularly any fees not subject to offset (as there would be no provision in the LPA to calculate the LP's share of a fee offset for which it was not entitled). These balances are denoted with a "****" in the Template. For these balances, GPs should only provide an estimated amount, using the LP's pro rata share of the Fund.

Due to the accounting complexity resulting from LP opt-outs and any specialized offset/waterfall provisions in certain LP side letters, LPs should understand that any individual LP's allocation for these balances are approximations and should only be used to provide context to any cumulative balances.

VII. Template Endorsement

To help communicate the scope of adoption within the industry, organizations are encouraged to endorse the Template. Instructions for endorsing the Template are provided on ilpa.org.

In general, a Template endorsement signals that the endorsing organization:

- Believes that a single standard for fee disclosures is necessary to efficiently monitor and report private equity fund activity
- Will make best efforts to adhere to all of the Template Guidelines
- Will not modify the Template beyond what is prescribed in the Template Guidelines (most notably, Sections VIII, IX, and XIII)
- Will not make, or comply with, requests to complete alternate, customized template formats that provide the same data points found in the ILPA Template
- Recognizes the challenges faced by GPs and LPs with regards to completing the Template and monitoring fees, respectively, and will make best efforts to collaborate with each other to ensure that the Template is applied in the most effective and efficient way

For LPs (and their consultants/administrators), an endorsement also indicates that:

- They're willing to encourage their GPs to complete and adopt the Template
- They will use content yielded by the Template to systematically monitor their portfolio
- They will phase-out use of any other formats they're using to gather fee data

For GPs (and their advisors), an endorsement also indicates that:

- In the short term, they're willing to complete the Template for any LP that requests it
- In the long term, they'll work towards implementing an automated solution that provides the Template to all of their LPs on a regular basis, as part of their standard reporting package

VIII. GP Modifications to Template

The Template-style format, with its hard-coded series of fields, was deemed most effective at creating a unified reporting standard, rather than a principles-based approach which was expected to only exacerbate the continuing proliferation of bespoke formats.

The prescribed fee data is presented alongside values typically included in a partners' capital account statement (PCAP) because it is believed that this PCAP information offers valuable context and quality control to the disclosures on fees and expenses. The ILPA acknowledges that standardizing the format for the PCAP itself is problematic, therefore this section is intended to detail acceptable modifications to the Template that allow GPs additional flexibility in its application.

GPs should not delete or merge any fields in the Template, including any of the more detailed itemization included as Level 2 content. If certain fields do not apply to a Fund, GPs are still advised to include these fields and populate them with zeros.

While Template fields should not be deleted or merged, GPs do have the flexibility to repurpose, supplement, or re-order the fields in Section A.1 (NAV Reconciliation and Summary of Fees, Expenses and Incentive Allocation) to accommodate for variances between their existing PCAP format and the one used in the Template (which is mostly relevant to U.S. GAAP-centric, commingled funds). While potentially beneficial to the industry, the purpose of the Initiative was not to standardize the format for PCAPs.

Some examples of acceptable modifications include:

• GPs whose PCAPs typically show the NAV reconciliation on a gross-of-carry basis, where periodic changes in accrued carry are indicated in separate line items, can adapt the Template format (which represents a net-of-carry basis) by adding and repurposing certain fields to match the basis of their standard PCAP. Regardless of any changes, the GP should still report any periodic changes in accrued/paid carried interest (in the section called "Reconciliation for Accrued Incentive Allocation").

• Additional fields that could be potentially inserted into Section A.1 include tax withholding, transfer of capital from a secondary purchase/sale, and currency gain/loss.

• Existing fields, such as Placement Fees, may be moved into the reconciliation of Net Operating Income, depending on the GP's existing reporting practices.

• GPs may rename fields to match the terminology in use within their country (e.g., Priority Profit Share is the more commonly used term for management fees in the U.K.).

• GPs may need to add or rename field names in the Level 1 content to accommodate funds that are denominated in multiple currencies, or with non-traditional or more complex fund structures (e.g., permanent capital and evergreen funds).

For any such revisions, GPs are encouraged to point out the explicit variations from the names or ordering of fields within the original ILPA Template, including explanatory footnotes, where appropriate. Some LPs may be relying on name-based Excel formulas (e.g., VLOOKUP) to aggregate content from reports provided by multiple GPs.

IX. LP Modifications and Adherence to the Template

One of the many benefits of a standardized Template is the reduced need for the GP community to process numerous, bespoke fee template requests from LPs. A single standard will make the reporting process more efficient and, over time, allow for greater comparability of information across managers and portfolios. As such, LPs should not modify any of the fields within the Template (including the accompanying Fund of Funds Template) before requesting that their GPs populate it.

However, LPs may request supplemental schedules that provide more clarity on any individual Template balance (e.g., itemized details on fee income received from individual portfolio companies). GPs should use their discretion when accommodating these supplemental Template requests.

Furthermore, LPs that adopt the Template are encouraged to transition away from using any customized template format that they're currently using to collect the same data provided in the Template. While it's understandable that they may use both their legacy format and the Template for a short period, it is counterproductive to encouraging broad adoption of these reporting standards to require the GP community to report in multiple formats over an extended period of time. For the avoidance of doubt, LPs that continue to request fee information via multiple formats after a reasonable transition period are not in compliance with these guidelines.

X. Footnotes

A footnotes section is provided at the bottom of the Template. GPs are encouraged to use this space to pre-emptively describe any out-of-the-ordinary balances. Also, GPs should footnote any YTD amounts that are classified in an "Other" balance (e.g., Partnership Expenses-Other, Other Offsets, etc.). Lastly, GPs should disclose in the footnotes if they have charged the Fund for any fund administration services that utilized in-house staff and infrastructure.

XI. Fee Allocations to Remaining Positions held by the Manager

In Section B.1 ("Source Allocation"), GPs are asked to provide a summary of all fees and reimbursements received by the GP and its affiliates from portfolio investments (under "With Respect to the Fund's Portfolio Companies/Investments"). Aggregate LPs' allocation for these fees are to be provided in the middle columns of the section (under "Cumulative LPs' Allocation of Total Fund"). In cases where the GP/affiliates have additional exposure to the Fund's investments (e.g., via LP co-investors or other funds/vehicles within the GP's fund family), any remaining allocation of the total fees received from investments held by the reported Fund should be provided in the far-right columns of the section (under "Affiliated Positions").

In total, the cumulative fee amounts received by the GP and its affiliates (including fees not subject to offset) should be accounted for (with care taken to avoid redundant entries or double-counting) in these two groups of columns. For the avoidance of any doubt, this section should not include any fees received by co-investors not under the umbrella of the GP/affiliates (e.g., other GPs or non-affiliated deal sponsors).

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XII. Fund of Funds Template

A supplemental schedule, which links to the Template, is provided to itemize the layer of fees and incentive allocation that a fund of funds ("FOF") pays to its underlying fund holdings. These values represent the normal fees and incentive allocation that the FOF paid via their commitment to each fund holding in the portfolio. The values do not include any pro-rata share of the fees charged by the FOF to its own LPs.

The ILPA acknowledges that any FOF will be highly challenged to provide the itemized content in the supplemental template. Like a traditional LP, the FOF's ability to track and report this content in a meaningful fashion to its own LPs is entirely contingent upon a uniform level of reporting and universal compliance from all of the underlying managers in the FOF's portfolio. As such, the ILPA recommends that FOF organizations provide the content in the supplemental schedule to LPs by special request only. The content should be reported in the format provided. The frequency and lag time of the reporting should be determined jointly by the FOF and the LP making the request.

XIII. Miscellaneous

• The Template was designed as a tool for standardizing the preferred level of disclosures on fees, expenses, and incentive allocation. It was not designed for verifying any of the GP's calculations for these amounts. To remain focused on this goal, certain metrics/terms used in these calculations (e.g. current management fee rate, preferred return rate, carry percentage, waterfall structure, etc.) are intentionally withheld from the Template. Subsequent to the release of the Template, the ILPA will issue additional guidance (in the form of a white paper and updates to the ILPA Principles) that will address the issue of LPA compliance.

• In the event of a transfer of interest between LPs (i.e., secondary purchase of an LP interest), historical activity should be presented in a manner that is consistent with a fund's standard reports.

•To match a traditional partners' capital account statement, values presented in Section A.1 (NAV Reconciliation and Summary of Fees, Expenses and Incentive Allocation) can have a positive or negative balance, depending upon how that value typically impacts the entity's wealth (e.g., increases in incentive allocation are a negative balance for LPs, a positive balance for the GP's allocation and a null balance for the Total Fund). However, balances in the remaining sections are typically presented as a positive balance (regardless of their impact on wealth). As such, Template users should avoid aggregating values from different sections.

• Current fee offset percentages are provided in Section A.1 in order to give interested LPs an approximation of total fees that are not subject to offset. LPs should be aware that potential nuances in how offset calculations are defined in an LPA (e.g., the offset percentages may increase/decrease over the life of the Fund) may make it difficult to use the Template to precisely calculate fees not subject to offset.

• When analyzing the fees charged by the GP to its investments, LPs should consider the potential accretive nature of any billable services rendered by the GP to the portfolio investment. LPs should also acknowledge that reimbursements paid by portfolio companies to the GP for amounts the GP has advanced to cover the cost of travel/services do not represent a source of revenue for the GP. Furthermore, GPs should acknowledge that LPs have an obligation to understand any non-"arms-length" engagement between a GP and portfolio company.

• The Total Fund balances presented in the Template should include all parallel vehicles/AIVs under the Fund's umbrella. Certain exceptions (e.g., funds denominated in multi-currencies) may apply.

• As in a traditional partners' capital account statement, partnership expenses presented in Section A.1 would not include any capitalized transaction fees charged to LPs.

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Best Practices Fund II, L.P.		QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)	QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)	QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)

A. Capital Account Statement for LP #5

A.1 NAV Reconciliation and Summary of Fees, Expenses & Incentive Allocation		***LP #5's Allocation of Total Fund***			***Total Fund (incl. GP Allocation)***			***GP's Allocation of Total Fund***		
		QTD	YTD	Since Inception	QTD	YTD	Since Inception	QTD	YTD	Since Inception
Beginning NAV - Net of Incentive Allocation		**$45,067,000**	**$38,196,000**	**$0**	**$2,495,281,787**	**$2,163,081,300**	**$0**	**$339,194,377**	**$276,104,050**	**$0**
Contributions - Cash & Non-Cash		0	5,000,000	35,000,000	0	250,375,000	1,752,625,000	0	375,000	2,625,000
Distributions - Cash & Non-Cash (input positive values)		1,250,000	5,000,000	19,000,000	62,593,750	250,375,000	1,452,175,000	2,593,750	12,875,000	77,175,000
Total Cash / Non-Cash Flows (contributions, less distributions)		**(1,250,000)**	**0**	**16,000,000**	**(62,593,750)**	**0**	**300,450,000**	**(2,593,750)**	**(12,500,000)**	**(74,550,000)**
Net Operating Income (Expense):										
(Management Fees – Gross of Offsets, Waivers & Rebates):		(187,500)	(750,000)	(6,625,000)	(9,375,000)	(37,500,000)	(331,250,000)	0	0	0
Management Fee Rebate		0	0	0	0	0	0	0	0	0
(Partnership Expenses - Total):		(48,000)	(154,780)	(548,429)	(2,328,750)	(4,985,053)	(25,072,055)	0	0	0
(Partnership Expenses – Accounting, Administration & IT)		*(1,000)*	*(2,500)*	*(27,000)*	*(50,000)*	*(128,000)*	*(1,350,000)*	*0*	*0*	*0*
(Partnership Expenses – Audit & Tax Preparatory)		*(2,000)*	*(5,000)*	*(58,000)*	*(100,000)*	*(250,000)*	*(2,600,000)*	*0*	*0*	*0*
(Partnership Expenses – Bank Fees)		*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
(Partnership Expenses – Custody Fees)		*(12,500)*	*(27,500)*	*(55,000)*	*(550,000)*	*(695,000)*	*(2,900,000)*	*0*	*0*	*0*
(Partnership Expenses – Due Diligence)		*(20,000)*	*(50,000)*	*(95,000)*	*(1,000,000)*	*(1,250,999)*	*(2,555,000)*	*0*	*0*	*0*
(Partnership Expenses – Legal)		*0*	*(37,500)*	*(250,000)*	*0*	*(1,875,000)*	*(12,500,000)*	*0*	*0*	*0*
(Partnership Expenses – Organization Costs)		*(10,000)*	*(25,000)*	*(50,000)*	*(500,750)*	*(628,000)*	*(2,522,500)*	*0*	*0*	*0*
(Partnership Expenses – Other Travel & Entertainment)		*(2,500)*	*(7,005)*	*(12,444)*	*(128,000)*	*(147,554)*	*(599,555)*	*0*	*0*	*0*
(Partnership Expenses – Other+)		*0*	*(275)*	*(985)*	*0*	*(10,500)*	*(45,000)*	*0*	*0*	*0*
Total Offsets to Fees & Expenses (applied during period):		82,600	346,500	1,538,521	4,140,600	19,227,400	82,424,249	0	0	0
Offset Categories	**% Offset to LP #5***									
Advisory Fee Offset	*80%*	*16,000*	*72,000*	*185,007*	*500,000*	*2,000,000*	*9,062,500*	*0*	*0*	*0*
Broken Deal Fee Offset	*80%*	*8,000*	*32,000*	*137,007*	*320,000*	*1,600,000*	*8,000,000*	*0*	*0*	*0*
Transaction & Deal Fee Offset	*80%*	*4,000*	*12,000*	*129,007*	*390,000*	*1,400,000*	*5,968,749*	*0*	*0*	*0*
Directors Fee Offset	*100%*	*600*	*2,500*	*37,500*	*30,000*	*875,000*	*6,875,000*	*0*	*0*	*0*
Monitoring Fee Offset	*100%*	*30,000*	*135,000*	*675,000*	*1,500,000*	*6,900,000*	*34,000,000*	*0*	*0*	*0*
Capital Markets Fee Offset	*100%*	*15,000*	*68,000*	*335,000*	*750,000*	*3,450,000*	*16,500,000*	*0*	*0*	*0*
Organization Cost Offset	*80%*	*8,000*	*20,000*	*40,000*	*400,600*	*502,400*	*2,018,000*	*0*	*0*	*0*
Placement Fee Offset	*100%*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Other Offset+	*80%*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Reconciliation for Unapplied Offset Balance (Roll-forward)										
Unapplied Offset Balance (Roll-forward) - Beginning Balance		*1,000*	*5,000*	*0*	*250,000*	*2,500,000*	*0*	*0*	*0*	*0*
Plus: Total Offsets to Fees & Expenses (recognized during period)		*81,600*	*341,500*	*1,538,521*	*3,890,600*	*16,727,400*	*82,424,249*	*0*	*0*	*0*
Less: Total Offsets to Fees & Expenses (applied during period)		*82,600*	*346,500*	*1,538,521*	*4,140,600*	*19,227,400*	*82,424,249*	*0*	*0*	*0*
Unapplied Offset Balance (Roll-forward) - Ending Balance		*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
(Total Management Fees & Partnership Expenses, Net of Offsets & Rebates, Gross of Fee Waiver)		(152,900)	(558,280)	(5,634,908)	(7,563,150)	(23,257,653)	(273,897,806)	0	0	0
Fee Waiver		0	7,500	25,000	0	375,000	1,250,000	0	0	0
Interest Income		500	1,000	10,000	25,038	50,075	500,750	38	75	750
Dividend Income		10,000	32,380	233,508	500,750	2,503,750	17,030,000	750	3,750	30,000
(Interest Expense)		(2,000)	(8,000)	(40,000)	(100,150)	(400,600)	(2,003,000)	(150)	(600)	(3,000)
Other Income/(Expense)+		1,000	3,000	20,000	50,075	150,225	1,001,500	75	225	1,500
Total Net Operating Income / (Expense)		**(143,400)**	**(522,400)**	**(5,386,400)**	**(7,087,438)**	**(20,579,203)**	**(256,118,556)**	**713**	**3,450**	**29,250**
(Placement Fees)		**0**	**0**	**(40,000)**	**0**	**0**	**(2,000,000)**	**0**	**0**	**0**
Realized Gain / (Loss)		**1,000,000**	**3,000,000**	**15,100,000**	**50,075,000**	**145,392,253**	**887,937,906**	**2,575,000**	**12,725,000**	**175,728,250**
Change in Unrealized Gain / (Loss)		**1,000,000**	**5,000,000**	**20,000,000**	**62,593,750**	**250,375,000**	**1,608,000,000**	**12,531,160**	**75,375,000**	**250,500,000**
Ending NAV - Net of Incentive Allocation		**$45,673,600**	**$45,673,600**	**$45,673,600**	**$2,538,269,350**	**$2,538,269,350**	**$2,538,269,350**	**$351,707,500**	**$351,707,500**	**$351,707,500**
Reconciliation for Accrued Incentive Allocation										
Accrued Incentive Allocation - Starting Period Balance		(4,750,000)	(3,750,000)	0	0	0	0	337,500,000	275,000,000	0
Incentive Allocation - Paid During the Period		50,000	250,000	1,250,000	0	0	0	(2,500,000)	(12,500,000)	(75,000,000)
Accrued Incentive Allocation - Periodic Change		(300,000)	(1,500,000)	(6,250,000)	0	0	0	15,000,000	87,500,000	425,000,000
Accrued Incentive Allocation - Ending Period Balance		(5,000,000)	(5,000,000)	(5,000,000)	0	0	0	350,000,000	350,000,000	350,000,000
Ending NAV - Gross of Accrued Incentive Allocation		$50,673,600	$50,673,600	$50,673,600	$2,538,269,350	$2,538,269,350	$2,538,269,350	$1,707,500	$1,707,500	$1,707,500

Best Practices Fund II, L.P.	QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)	QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)	QTD (Oct-15 - Dec-15)	YTD (Jan-15 - Dec-15)	Since Inception (Feb-07 - Dec-15)
A.2 Commitment Reconciliation:	***LP #5's Allocation of Total Fund***			***Total Fund (incl. GP Allocation)***			***GP's Allocation of Total Fund***		
Total Commitment	**$50,000,000**	**$50,000,000**	**$50,000,000**	**$2,503,750,000**	**$2,503,750,000**	**$2,503,750,000**	**$3,750,000**	**$3,750,000**	**$3,750,000**
Beginning Unfunded Commitment:	**$18,500,000**	**$23,500,000**	**$50,000,000**	**$926,387,500**	**$1,176,762,500**	**$2,503,750,000**	**1,387,500**	**1,762,500**	**3,750,000**
(Less Contributions)	0	(5,000,000)	(35,000,000)	0	(250,375,000)	(1,752,625,000)	0	(375,000)	(2,625,000)
Plus Recallable Distributions	0	0	4,000,000	0	0	200,300,000	0	0	300,000
(Less Expired/Released Commitments)	0	0	0	0	0	0	0	0	0
+/- Other Unfunded Adjustment	0	0	(500,000)	0	0	(25,037,500)	0	0	(37,500)
Ending Unfunded Commitment	**$18,500,000**	**$18,500,000**	**$18,500,000**	**$926,387,500**	**$926,387,500**	**$926,387,500**	**$1,387,500**	**$1,387,500**	**$1,387,500**

A.3 Miscellaneous** (input positive values):	***LP #5's Allocation of Total Fund***			***Total Fund (incl. GP Allocation)***			***GP's Allocation of Total Fund***		
Incentive Allocation - Earned (period-end balance)****	$1,250,000	$1,250,000	$1,250,000	$0	$0	$0	$75,000,000	$75,000,000	$75,000,000
Incentive Allocation - Amount Held in Escrow (period-end balance)****	$250,000	$250,000	$250,000	$0	$0	$0	$15,000,000	$15,000,000	$15,000,000
Returned Clawback****	$0	$0	$0	$0	$0	$0	$0	$0	$0
Capitalized Transaction Fees & Exp. - Paid to Non-Related Parties****	$50,000	$200,000	$1,000,000	$2,503,750	$10,015,000	$50,075,000			
Distributions Relating to Fees & Expenses****	$2,500	$10,000	$58,000	$125,188	$500,750	$2,904,350			
Fund of Funds: Gross Fees, Exp. & Incentive Allocation paid to the Underlying Funds****	$1,951	$7,806	$24,626	$97,720	$390,879	$1,233,161			

B. Schedule of Fees, Incentive Allocation & Reimbursements Received by the GP & Related Parties, with Respect to the Fund and Portfolio Companies/Investments Held by the Fund

B.1 Source Allocation:		***LP #5's Allocation of Total Fund***			***Cumulative LPs' Allocation of Total Fund***			***Affiliated Positions******		
With Respect to the Fund's LPs	Management Fees - Net of Rebates, Gross of Offsets and Waivers	187,500	750,000	6,625,000	9,375,000	37,500,000	331,250,000			
	Partnership Expenses - Paid to GP & Related Parties - Gross of Offsets	1,000	4,000	30,000	50,075	200,300	1,502,250			
	(Less Total Offsets to Fees & Expenses - applied during period)	(82,600)	(346,500)	(1,538,521)	(4,140,600)	(19,227,400)	(82,424,249)			
	Capitalized Transaction Fees & Exp. - Paid to GP & Related Parties****	0	0	0	0	0	0			
	Accrued Incentive Allocation - Periodic Change	300,000	1,500,000	6,250,000	15,000,000	87,500,000	425,000,000			
With Respect to the Fund's Portfolio Companies/ Invs.	Total Fees with Respect to Portfolio Companies/Investments:	80,600	350,500	1,611,277	3,792,500	17,475,000	86,164,062	$947,225	$4,342,500	$21,334,765
	*Advisory Fees*****	*20,000*	*90,000*	*231,259*	*625,000*	*2,500,000*	*11,328,125*	*156,250*	*625,000*	*2,832,031*
	*Broken Deal Fees*****	*10,000*	*40,000*	*171,259*	*400,000*	*2,000,000*	*10,000,000*	*100,000*	*500,000*	*2,500,000*
	*Transaction & Deal Fees*****	*5,000*	*15,000*	*161,259*	*487,500*	*1,750,000*	*7,460,937*	*121,875*	*437,500*	*1,865,234*
	*Directors Fees*****	*600*	*2,500*	*37,500*	*30,000*	*875,000*	*6,875,000*	*6,600*	*192,500*	*1,512,500*
	*Monitoring Fees*****	*30,000*	*135,000*	*675,000*	*1,500,000*	*6,900,000*	*34,000,000*	*375,000*	*1,725,000*	*8,500,000*
	*Capital Markets Fees*****	*15,000*	*68,000*	*335,000*	*750,000*	*3,450,000*	*16,500,000*	*187,500*	*862,500*	*4,125,000*
	*Other Fees****, +*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
	Total Reimbursements for Travel & Administrative Expenses****	5,000	15,000	62,200	200,000	600,000	248,800	8,000	19,500	88,500
Total Received by the GP & Related Parties		**$491,500**	**$2,273,000**	**$13,039,956**	**$24,276,975**	**$124,047,900**	**$761,740,863**	**$955,225**	**$4,362,000**	**$21,423,265**

*Current offset percentages for the specific LP; As offset calculations may change over the life of the Fund, the current offset percentages may not be applicable for calculating the non-QTD offset balances

**Content in A.3 aims to provide users with additional context on the balances provided in other sections; Some of the balances in A.3 represent a sub-total for an amount provided in another section; Balances in this section should be entered as a positive amount, even though similar balances in other sections may typically be presented as a negative amount; To prevent double-counting, or other miscalculations, users should avoid netting balances in A.3 with amounts in other sections

***Balances in this section represent fees & reimbursements received by the GP/Manager/Related Parties with respect to the Fund's investments that are not allocable to the Total Fund (i.e. allocated to ownership interests of LP co-investors & other vehicles managed-by/affiliated-with the GP/Manager/Related Party); To avoid double-counting, LP # 5's Allocation of Total Fund should not reflect any pro-rata share of these positions; Balances in this section, plus the balances in the "Cumulative LPs' Allocation of Total Fund" section, should equal the total fees/reimbursements received by the GP/Manager/Related Parties With Respect to the Fund's Portfolio Companies/Invs.

****Allocation for individual LPs, the Total Fund and all remaining positions may need to be estimated on a pro-rata basis

+A description should be provided in the footnote section for any amount(s) listed in this row for the year-to-date period

Shaded/Italicized/Grouped Content Represents Level 2 Data

Footnotes for any YTD (Total Fund) expenses, fees & offsets (including any "other" balances)

Partnership Expenses – Other ($10,500) = Insurance ($8,000) + Partnership-Level Taxes ($2,500)

Fund of Funds Template: Fees, Expenses & Incentive Allocation to Underlying Funds (values in "Parent" Fund Currency)

"Parent" Fund Name:	Best Practices Fund II, L.P.
"Parent" Fund Currency:	USD
"Parent" Fund Size:	$2,503,750,000
LP #5 Commitment to "Parent" Fund:	$50,000,000
Period Ending:	Dec. 31, 2015

	Underlying "Child" Fund				Fees, Expenses & Incentive Allocation Paid by "Parent" Fund to "Child" Funds (Total Fund, Incl. GP Allocation - Reported in "Parent" Fund Currency)														
					Management Fees – Gross of Offsets, Waivers & Rebates			Management Fees – Net of Offsets, Waivers & Rebates			Partnership Expenses - Total			Incentive Allocation - Paid			Incentive Allocation - Periodic Change in Accrued		
	Name	Commitment Amount	Vintage	Currency	QTD	YTD	Since Inception	QTD	YTD	Since Inception	QTD	YTD	Since Inception	QTD	YTD	Since Inception	QTD	YTD	Since Inception
1	ABC Venture Partners III, L.P.	$100,000,000	2008	USD	$4,993	$19,970	$239,641	$4,743	$18,972	$227,659	$2,496	$9,985	$119,820	$25,000	$100,000	$120,000	$1,672	$6,690	$80,280
2	XYZ Capital Partners II, L.P.	$50,000,000	2012	USD	$3,994	$15,976	$179,730	$3,794	$15,177	$170,744	$1,997	$7,988	$89,865	$20,000	$80,000	$90,000	$1,338	$5,352	$60,210
3	European Venture Partners IV, L.P.	$109,065,000	2013	EUR	$5,295	$21,179	$42,358	$5,030	$20,120	$40,240	$2,647	$10,590	$21,179	$26,514	$106,054	$175,888	$1,774	$7,095	$14,190
4																			
5																			

ILPA Fee Reporting Template - Definitions

ILPA Reporting Template (v. 1.1) - This packet was last updated on Oct. 17, 2016

Section	Field	Definition
A1. NAV Reconciliation	LP's Allocation of Total Fund	Balances that represent a single LP's interest in the Total Fund; Estimations are acceptable for any single LP amount that's denoted with a "****"
	Total Fund (incl. GP Allocation)	Balances that represent the cumulative interest of a single fund, including all of its side/parallel vehicles (current and liquidated)
	GP's Allocation of Total Fund	Balances that represent the interest of the legal entity, including any Related Parties, that manages the fund
	Beginning NAV - Net of Incentive Allocation	The valuation of the Fund at the beginning of the period for a given investor, or group of investors; This balance is reflective of any incentive allocation that was attributable to the GP at the beginning of the period; Per Section VIII of the Template Guidelines, GPs may also report this value without first attributing incentive allocation (i.e., Gross of Incentive Allocation); See Section VIII of the Template Guidance for more details
	Non-Cash Contributions & Distributions	Includes any in-kind transactions (e.g., stock distributions) and/or "netted" transactions (i.e., call and distribution called on the same date that fully offset each other)
	Management Fee Rebate	Refund of any prior management fees to the Fund's investors
	Partnership Expenses – Accounting, Administration & IT	Expenses charged to the Fund for fund administration, including accounting, valuation services, filing fees and IT activities; ***Any YTD expenses attributed to internal staff, Related Parties and/or internal infrastructure must be footnoted in this document***; Excludes expenses for audit and tax preparation
	Partnership Expenses – Audit & Tax Preparatory	Expenses charged to the Fund for the audit of the Fund's financial records and for the preparation of any tax documents related to the Fund; Excludes any costs related to organizing the Fund, investment due diligence and fund administration expenses
	Partnership Expenses – Bank Fees	Expenses charged to the Fund for banking/finance services; Excludes fund administration expenses and interest; Includes fees related to credit facilities and other short-term financing at the fund level
	Partnership Expenses – Custody Fees	Expenses charged to the Fund for the registration of securities and other custody-related activities; Excludes fund administration expenses
	Partnership Expenses – Due Diligence	Expenses charged to the Fund to confirm all material assumptions in regards to potential investment opportunities; Includes all costs that can be clearly linked to the due diligence of specific investment opportunities including legal, travel and other costs; Includes both consummated and unconsummated deals; Exclude management fees and the costs of identifying and sourcing potential investment opportunities; Excludes fund administration expenses
	Partnership Expenses – Legal	Expenses charged to the Fund for legal services on behalf of the Fund; Includes legal analysis to interpret or amend the Fund's LPA; Excludes any legal costs associated with organizing/administering the fund or investment due diligence
	Partnership Expenses – Organization Costs	Expenses charged to the Fund for the establishment of the Fund, including any legal/audit costs; Excludes any fund administration expenses or Placement Fees
	Partnership Expenses – Other Travel & Entertainment	Expenses charged to the Fund related to travel & entertainment on behalf of the Fund; May include travel related to LPAC meetings or unreimbursed portfolio company meetings; Excludes travel costs associated with due diligence
	Partnership Expenses – Other	Expenses charged to the Fund, not described elsewhere; May include annual meeting expenses, insurance, partnership level taxes, and deal origination/monitoring expenses; May include fees paid to the Fund's directors and advisory committee members; Explanations for any YTD amounts included in this field must be footnoted in this document
	Total Offsets to Fees & Expenses (applied during period)	Total amount that recognized fund management fees/expenses were reduced by during the period, to the benefit of the Fund's investors, resulting from fees/expenses received by the GP/Manager/Related Party; Applied offset amount does not necessarily represent the total amount of recognized fees/expenses that were subject to offset during the period, as the applied amount typically cannot exceed the total recognized, gross fund management fees/expenses during the period
	Advisory Fee Offset	Offset (gross of any unapplied balance) for any fees/costs paid to the GP/Manager/Related Party relating to consultancy services provided to portfolio companies; Advisory fees are provided through project-based services with no ongoing monitoring style fees; Compensation is based on hourly or task-based fees; Excludes services related to Transaction & Deal Fees
	Broken Deal Fee Offset	Offset for any termination fees/costs received from counterparties of the Fund's unconsummated deals; Typically netted (subject to the Fund's LPA) against any unreimbursed termination fees/costs paid to counterparties; Amount is gross of any unapplied balances during the period
	Transaction & Deal Fee Offset	Offset (gross of any unapplied balance) for any fees/costs paid to the GP/Manager/Related Party regarding the purchase and sale of investments (excl. Broken Deal Fees); Include fees/exp. related to any bolt-on acquisitions for the portfolio company
	Directors Fee Offset	Offset (gross of any unapplied balance) for any fees paid to the GP/Manager/Related Party (including any fees paid directly to individuals) for their role on a portfolio company's board of directors; Includes any non-cash compensation (e.g., stock)

ILPA Reporting Template (v. 1.1) - This packet was last updated on Oct. 17, 2016

Section	Field	Definition
A1. NAV Reconciliation	Monitoring Fee Offset	Offset (gross of any unapplied balance) for any fees, including accelerated monitoring fees, paid to the GP/Manager/Related Party as part of an agreement between the portfolio company and the GP/Manager/Related Party over a finite or indefinite period; Monitoring fees are identified as ongoing management services provided to portfolio companies, based on annually established fees as opposed to hourly or task based fees
	Capital Markets Fee Offset	Offset (gross of any unapplied balance) for any fees/costs paid to the GP/Manager/Related Party for their role in securing financing for a company; Excludes any Transaction & Deal Fees
	Organization Cost Offset	Offset (gross of any unapplied balance) for any costs related to the establishment of the Fund; Typically, LP offsets are provided for amounts in excess of a predetermined value; Exclude any offsets for Placement Fees
	Placement Fee Offset	Offset (gross of any unapplied balance) for fees/costs paid to the GP/Manager/Related Parties, or paid to outside parties, for fundraising services
	Other Offsets	Offset (gross of any unapplied balance) for any remaining fees/costs paid to the GP/Manager/Related Party, subject to LP offset, not listed elsewhere; Explanations for any YTD amounts included in this field must be footnoted in this document
	Unapplied Offset Balance (Roll-forward) - Beginning Balance	Prior period, ending-balance for any fees/expenses, subject to offset against fund management fees/expenses, that have been recognized, but not yet credited to the benefit of the Fund's investors
	Total Offsets to Fees & Expenses (recognized during period)	Periodic fees/expenses, subject to offset against fund management fees/expenses, that were credited to the benefit of the Fund's investors; This amount may not necessarily equal the offset amount applied during the period, as the applied amount cannot typically exceed the total amount of total recognized, gross fund management fees/expenses during the period
	Unapplied Offset Balance (Roll-forward) - Ending Balance	Current period, ending-balance for any fees/expenses, subject to offset against fund management fees/expenses, that have been recognized, but not yet credited to the benefit of the Fund's investors
	Total Management Fees & Partnership Exp., Net of Offsets & Rebates, Gross of Fee Waiver	Periodic gross management fees and fund expenses, less any Fee Waiver and Total Offsets to Fees & Expenses (applied during the period)
	Fee Waiver	Any waiver of management fees in lieu of assuming the GP's commitment obligations to the Fund
	Placement Fees	Fees/costs paid to the GP/Manager/Related Party, or to outside parties, for fundraising services; These fees are sometimes not an income statement line-item in a fund's financial records, but rather a direct reduction to partners' capital; GP may relocate this row, depending on how it is treated on their income statement
	Realized Gain / (Loss)	Changes in the Fund's valuation, attributable to full or partial sales of investments; Please note that gain/loss in the Template is presented on a net-of-incentive-allocation-basis; Per Section VIII of the Template Guidelines, GPs could also report the gain/loss can on a gross-basis; See Section VIII of the Template Guidance for more details
	Change in Unrealized Gain / (Loss)	Changes in the Fund's valuation, attributable to investments still held by the Fund; Please note that gain/loss in the Template is presented on a net-of-incentive-allocation-basis; Per Section VIII of the Template Guidelines, GPs could also report the gain/loss on a gross-basis; See Section VIII of the Template Guidance for more details
	Ending NAV - Net of Incentive Allocation	The valuation of the Fund at the end of the period for a given investor, or group of investors; This balance is reflective of any incentive allocation that was attributable to the GP at the end of the period; Per Section VIII of the Template Guidelines, GPs may also report this value without first attributing incentive allocation (i.e., Gross of Incentive Allocation); See Section VIII of the Template Guidance for more details
	Accrued Incentive Allocation - Starting Period Balance	Prior period, ending-balance for GP's/Manager's/Related Parties' expected share of any unrealized profits that would be paid upon realization of all remaining investments, based on current valuations (also known as Carried Interest or GP Profit Share), less any potential Clawback obligation; Balance also includes any uncollected profits from realized investments, if applicable
	Incentive Allocation - Paid During the Period	GP's/Managers'/Related Parties' share of any realized profits from an investment (also known as Carried Interest and GP Profit Share), less any returned Clawback; Balance only reflects Incentive Allocation collected by the GP/Related Parties, including amounts held in escrow
	Accrued Incentive Allocation - Periodic Change	Periodic change in GP's/Managers'/Related Parties' expected share of any unrealized profits that would be paid upon realization of all remaining investments, based on current valuations (also known as Carried Interest and GP Profit Share), less any potential Clawback obligation; Change also includes any uncollected profits from realized investments, if applicable
	Accrued Incentive Allocation - Ending Period Balance	Current period, ending-balance for GP's/Manager's/Related Parties' expected share of any unrealized profits that would be paid upon realization of all remaining investments, based on current valuations (also known as Carried Interest or GP Profit Share), less any potential Clawback obligation; Balance also includes any uncollected profits from realized investments, if applicable
A3. Misc.	Incentive Allocation - Earned (period-end balance)	Estimated period-end balance for GP's/Managers'/Related Parties' share of any realized profits from investments (aka Carried Interest and GP Profit Share), less any Returned Clawback; Balance reflects all incentive allocation entitled to the GP/Related Parties (attributable to realizations), including amounts held in escrow and/or not yet collected by the GP
	Incentive Allocation - Amount Held in Escrow (period-end balance)	Period-End balance for the portion of the GP's/Managers'/Related Parties' share of any realized profits from investments (aka Carried Interest and GP Profit Share) that has been collected, but is currently held in a third party account until certain milestones are met (per the Fund's LPA)
	Returned Clawback	Excess Incentive Allocation paid to the GP/Manager/Related Parties, including amounts held in escrow, which has been returned to the Fund
	Capitalized Transaction Fees & Exp. - Paid to Non-Related Parties	Any fees & expenses rolled into the cost-basis of the Fund's investments that are paid by the Fund's investors to non-Related Parties
	Distributions Relating to Fees & Expenses	Estimated portion of distributions that are attributed to the return of any fees/expenses paid; Typically returned by the GP before any Incentive Allocation is captured as part of the waterfall calculation
	Fund of Funds: Gross Fees, Exp. & Incentive Allocation paid to the Underlying Funds	Additional layer of fees/expenses/Incentive Allocation (incl. accruals) charged by the underlying funds held by the Fund-of-Funds; Excludes any fees/expenses/Incentive Allocation charged by the Fund-of-Fund (the 'parent' fund) that manages the underlying funds ('child' funds); Fields are linked to a supplemental template (Fund of Funds-Underlying); LP balances are estimates

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Section	Field	Definition
B1. Source Allocation	Related Party	See "Related Party Definition" tab
	With Respect to the Fund's LPs	Fees, expenses and incentive allocation paid/accrued by the Fund's LPs to the GP/Management/Related Parties; Excludes any expenses that are paid to non-Related Parties
	With Respect to the Fund's Portfolio Companies/Invs.	Fees, expenses and reimbursements paid/accrued by (or in regards to) the Fund's portfolio holdings (incl. fees not subject to offsets) to the GP/Manager/Related Parties; Include any fees received from 3rd parties regarding arrangements for the investment (e.g., purchasing discount fees), and any fees received after the liquidation of the Fund or any sleeve/AIV of the Fund
	Cumulative LPs' Allocation of Total Fund	Balances that represent the cumulative interest of a single fund, including all of its side/parallel vehicles (current and liquidated), less the GP's Allocation of Total Fund
	Partnership Expenses - Paid to GP & Related Parties - Net of Offsets	Share of total partnership expenses (including any placement fees or other charges that are treated as direct reduction to partners capital) paid to the GP/Manager/Related Parties for services provided to the Fund; Excludes expenses paid to non-Related Parties that are advanced out of the management company's reserves until the expense can be called from the Fund's LPs (aka "pass-through" transactions)
	Capitalized Transaction Fees & Exp. - Paid to GP & Related Parties	Any fees & expenses rolled into the cost-basis of the Fund's investments that are paid by the Fund to the GP/Manager/Related Parties; Excludes expenses paid to non-Related Parties that are advanced out of the management company's reserves until the expense can be called from the Fund's LPs (aka "pass-through" transactions)
	Advisory Fees	Fees/costs that are paid/accrued to the GP/Manager/Related Parties (incl. any fees not subject to offset) relating to consultancy services provided to portfolio companies; Advisory fees are provided through project-based services with no ongoing monitoring style fees; Compensation is based on hourly or task-based fees; Excludes services related to Transaction & Deal Fees
	Broken Deal Fees	Termination fees/costs received from counterparties of the Fund's unconsummated deals, netted against any termination fees/costs paid to counterparties that weren't reimbursed by the Fund; Include any fees not subject to offset
	Transaction & Deal Fees	Fees/costs that are paid/accrued to the GP/Manager/Related Party (incl. any fees not subject to offset) regarding the purchase and sale of investments; Excludes broken deal fees; Include fees/exp. related to bolt-on acquisitions for the portfolio company
	Directors Fees	Fees/costs that are paid/accrued (gross of any unapplied offset balance) to the GP/Manager/Related Party (incl. any fees paid directly to individuals and/or any fees not subject to offset) for their role on the portfolio company's board of directors; Includes any non-cash compensation (e.g., stock)
	Monitoring Fees	Fees/costs, including accelerated monitoring fees, that are paid/accrued to the GP/Manager/Related Party (incl. any fees not subject to offset) as part of an agreement between the portfolio company and the GP/Manager/Related Party over a finite or indefinite period; Monitoring fees are identified as ongoing management services provided to portfolio companies, based on annually established fees as opposed to hourly or task based
	Capital Markets Fees	Fees/costs that are paid/accrued to the GP/Manager/Related Party (incl. any fees not subject to offset) for their role in securing financing for a portfolio company
	Other Fees	Any remaining fees/costs that are paid/accrued to the GP/Manager/Related Party (incl. any fees not subject to offset) not listed elsewhere; Explanations for any YTD amounts included in this field must be footnoted in this document
	Total Reimbursements for Travel & Administrative Expenses	Repayment of any travel or other administrative expenses from the Fund's portfolio investment to the GP/Manager/Related Party

ILPA Reporting Template (v. 1.1) - This packet was last updated on Oct. 17, 2016

The ILPA acknowledges that the definition of 'Related Parties' can vary from manager to manager, and is typically linked to specific language in a fund's LPA. The ILPA also acknowledges that it's unlikely a manager would track and report Related Party activities that did not fall within the scope of any previously agreed upon definition. However, to ensure that a consistent standard is applied to any future funds, the ILPA strongly recommends the use of the following Related Party definition in any disclosures for funds with an inception date after March 1, 2016:

Operational Person(s) means any operational partner, senior advisor or other consultant or employee whose primary activity for a Relevant Entity is to provide operational or back office support to any portfolio company of any investment vehicle, account or fund managed by a Related Person.

Related Person(s) means any current or former employee, manager or partner of any Relevant Entity which employee, manager or partner is involved in the investment activities or accounting and valuation functions of such Relevant Entity or any of their respective family members.

Related Party(ies) means (i) any Related Person, (ii) any Operational Person, (iii) any entity more than [10]% of the ownership of which is held directly or indirectly (whether through other entities or trusts) by any Related Person or Operational Person and whether or not such Related Person or Operational Person participates in the carried interest received by the General Partner or the Special Limited Partner, and (iv) any consulting, legal or other service provider regularly engaged by portfolio companies of any investment vehicle, account or fund managed by a Related Person and which also provides advice or services to any Related Person or Relevant Entity.

Relevant Entity(ies) means the General Partner, any separate carry vehicle, the Investor Advisor or any of their parent or subsidiary entities or any similar entity related to any other investment vehicle, account or fund advised or managed by any current or former Related Person.