Analysis of the Maryland State Retirement and Pension System's Asset Management Practices

Prepared for
Governor's Office of Minority Affairs
Pursuant to Chapter 577 of 2012, Annotated Code of Maryland

By
Regional Economic Studies Institute
TOWSON UNIVERSITY

Daraius Irani, Ph.D., Executive Director
Susan Steward, Economist
Rebecca Ebersole, Senior Research Associate
Jade Clayton, Research Assistant

January 22, 2013

Table of Contents

1.0 Executive Summary 4
1.1 Outreach by Internal Staff 4
1.2 Role of External Staff 4
1.3 Application, Evaluation, and Approval 5
1.4 Utilization 5
1.5 Overall Program Goals 6
1.6 Graduation Requirements 6
2.0 Introduction 7
3.0 Findings 9
3.1 Outreach by Internal Staff 10
3.2 Role of External Staff and Consultants 12
3.3 Application, Evaluation, and Approval 14
3.4 Utilization 16
3.5 Overall Program Goals 27
3.6 Graduation Requirements 31
4.0 Conclusions and Recommendations 32
4.1 Conclusions 32
4.2 Recommendations 32
5.0 References 36
Appendix A—Interview Questions 39
A.1 State Retirement and Pension System Staff 39
A.2 SRPS Follow-up 40
A.3 Terra Maria Program Managers 41
A.4 Terra Maria Emerging Managers 42
Appendix B—Summary of Contacts and Responses 43
B.1 State Retirement and Pension System Contacts and Responses 43
B.2 Terra Maria Program Managers Contacts and Responses 48
B.3 Terra Maria Emerging Managers Contacts and Responses 51
B.4 External Contacts 56

Table of Figures

Figure 1: SRPS Minority- and Woman-Owned Firms, FY 2008 – FY 2011 17
Figure 2: Terra Maria Program Managers by Minority Status, FY 2009 – FY 2011 19
Figure 3: Utilization of Minority Managers by Classification, FY 2011 19
Figure 4: Demographics of Emerging Managers by Classification, FY 2009 – FY 2011..... 23
Figure 5: Demographics of Emerged Managers by Classification, FY 2009 – FY 2011..... 23
Figure 6: Allocations to Emerging Managers, FY 2009 – FY 2011..... 24
Figure 7: Allocations to Emerged Minority Managers, FY 2009 – FY 2011..... 24
Figure 8: Emerging to Emerged Managers, FY 2009 – FY 2011..... 25
Figure 9: Terminated Emerging Managers by Classification, FY 2009 – FY 2011..... 26
Figure 10: Performance Benchmarks by Asset Class, FY 2011..... 28
Figure 11: Minority- and Woman-Owned Firm Performance, FY 2012..... 29
Figure 12: Target Allocations by Asset Class, FY 2008 – FY 2012 30
Figure 13: Contacts by Date of Interview, Firm, and Title—SRPS 43
Figure 14: Summary of Responses—SRPS..... 43
Figure 15: Contacts by Date of Interview, Firm, and Title—Program Managers 48
Figure 16: Summary of Responses—Program Managers..... 48
Figure 17: Summary of Perceived Strengths and Weaknesses—Program Managers 51
Figure 18: Contacts by Date of Interview, Firm, and Title—Emerging Managers 52
Figure 19: Summary of Responses—Emerging Managers..... 53
Figure 20: Summary of Perceived Strengths and Weaknesses—Emerging Managers 54
Figure 21: Contacts by Date of Interview, Firm, and Title—External Contacts 56
Figure 22: Summary of Perceived Strengths and Weaknesses—External Contacts 56

1.0 Executive Summary

The Governor's Office of Minority Affairs (GOMA) has requested that the Regional Economic Studies Institute (RESI) of Towson University assist them in producing a report as specified in Section 2 of Senate Bill 779, which requires a study of the asset management practices of Maryland's State Retirement and Pension System (SRPS) as they relate to inclusion of minority- and woman-owned investment management and brokerage firms as outlined by Senate Bill 606.

RESI's key findings are focused on six key areas as summarized below: (1) outreach; (2) role of external staff; (3) application, evaluation, and approval; (4) utilization; (5) overall program goals; and (6) graduation requirements.

1.1 Outreach by Internal Staff

Overall, RESI found that SRPS could improve its outreach efforts in comparison to other states. RESI identified the following in regard to outreach:

- SRPS reported using questionnaires, meetings with prospective managers, press inquiries, surveys and requests for information, and conferences as race-neutral outreach methods. Based on the literature review, SRPS's current outreach methods appear on par with the level of effort set forth by other states' pensions systems based on the literature review.
- However, after conducting interviews, RESI found that the quality of SRPS staff's participation in outreach activities was not commensurate with the outreach of other states. Section 3.1 notes remarks from an interview that SRPS did not attend as many conferences as they had reported.
- A number of minority- and woman- owned firms gained assets from SRPS through existing relationships with program managers. In comparison, those managers without an existing connection to a program manager found it difficult to meet or communicate with the Investment Division staff or consultants and as such were ultimately less successful in obtaining assets.

1.2 Role of External Staff

RESI found that consultants and managers working contractually as external staff for SRPS have three main roles: (1) performing outreach and maintaining databases, (2) providing recommendations for asset allocation to the CIO and (3) managing other external staff for the Investment Division.

- SRPS uses external consultants, managers-of-managers, and investment managers who are contractually required to act as fiduciaries of the System.
- Termination or retaining of managers, while ultimately performed by the CIO, is based on adherence to the agreed fiduciary duties or on each manager's realized performance reported by external consultants and program managers.
- Manager-of-managers are the program managers in the Terra Maria program who are responsible for managing the emerging and emerged investment managers for SRPS.
- Altius is the investment consultant used by SRPS for the creation and maintenance of a database of all investment managers to follow manager activity and progress over time.
- Altius is in the process of adding emerging and minority-owned private equity management firms to its database for SRPS.

- Any recommendation by external staff must also be supported and made by internal staff to the CIO. The CIO makes the final decision on whether to hire a firm or not. The process of internal approval is in place to ensure adherence to fiduciary standards.
- As mentioned in Section 1.1, the external staff appears to perform outreach more effectively compared to SRPS's internal staff. A majority of minority- and woman-owned managers interviewed by RESI stated having some connection to an external manager or consultant was key in obtaining funds from SRPS.

1.3 Application, Evaluation, and Approval

A comprehensive and well maintained database has been a key indicator in the literature review that a system is performing its due diligence. Interviews with program managers and minority investment managers confirmed that due diligence performed by SRPS and its external staff was exemplary in comparison to other states. More specifically, RESI found the following in regard to application, evaluation, and approval:

- Interviews with SRPS have verified that an investment consultant, Altius Associates, uses a comprehensive database that allows for the ongoing monitoring of potential investment managers.
- SRPS's internal staff conducts quarterly, monthly, and semiannual due diligence to ensure that its investment managers are meeting fiduciary standards.
- Treatment toward and growth of investment managers, once hired by SRPS, has been perceived to be fair by most interviewed managers, but comments by other managers indicate the need for clarity of SRPS's performance requirements for receipt of additional allocations or for graduation.
- An observation by one of the interviewees outside SRPS was that the hands-on approach of the Investment Division leads to the addition of extra responsibility to the existing staff. Entrusting more responsibility or vetting of managers to its consultants and program managers may increase the overall staff's capacity to identify and select minority managers, especially in the private markets where minority inclusion is particularly lacking.

1.4 Utilization

While inclusion of minority- and woman-owned investment management firms by SRPS has improved overall since the passing of SB 606, the comparison to other states reveals weaknesses. RESI found the following in regard to utilization and goal setting for SRPS:

- According to SRPS, managers in the Terra Maria program (SRPS's emerging manager program) are generally given at least $10 million in assets under management (AUM), which is higher than the typical amount of AUM allocated to emerging managers in traditional programs.
- SRPS has yet to gain a diverse group of investment managers and brokers that is representative of the state's population or of the investment firms available in Maryland.

1.5 Overall Program Goals

SRPS has established custom benchmarks by asset category to gauge the performance of the Terra Maria Program. RESI found the following:

- Overall performance by minority- and woman-owned firms investing for SRPS has been positive, but FY 2011 data shows some underperformance in public equity mandates performed by both minority and majority firms.
- The high-return, high risk investments in fixed income and credit strategies by minority- and woman-owned firms investing for SRPS have kept overall performance of the program positive.
- The growing allocation target for private markets within Terra Maria and the greater portfolio will greatly impact future inclusion of minority- and woman-owned firms within SRPS's portfolio.
- Maryland's SRPS has no specific policy for broker utilization nor does it specify policy concerning the use of step-out commissions to brokers.

1.6 Graduation Requirements

A comparison of SRPS's Terra Maria program to other states' emerging manager programs raises concern over SRPS's informal graduation process and whether or not the informal process benefits minority firms. More specifically, RESI found the following in regard to graduation requirements:

- SRPS's exclusion of size standards for its emerging managers allows for emerging managers to remain in the program until SRPS's larger portfolio has the capacity for that manager's investment strategy.
- Since FY 2009 several emerging managers have moved to emerged status, allowing for increases in assets for minority managers including Brown Capital Management, Earnest Partners, and Rock Creek Potomac Fund.
- The informal process has also been viewed, based on interviews, as a concern because it allows SRPS staff to be subjective in its decision to graduate or terminate emerging managers due to a lack of formal policy.

2.0 Introduction

In 2008, the Maryland General Assembly passed Senate Bill 606/House Bill 1277 – *State Government – Brokerage and Investment Services – Use of Minority Business Enterprises*, codified under Chapter 600.[1] The statute requires the State Retirement and Pensions System (SRPS), the Treasurer's Office, the Injured Workers Insurance Fund (IWIF), and the Maryland Automobile Insurance Fund (MAIF), to attempt to use minority businesses to the greatest extent feasible to provide brokerage and investment management services. According to Senate Bill 606 (SB 606), "the four entities' use of minority businesses must be consistent with MBE purchasing standards in current law and with their respective fiduciary responsibilities."[2] The statute also required GOMA to collaborate with and advise the four agencies specified in the law. Specifically, GOMA is required "to develop guidelines to implement the bill's provisions and to submit annual reports" to the General Assembly.[3]

In 2012, Senate Bill 779, codified as Chapter 577, required GOMA to conduct a study of the asset management practices of SRPS as they relate to the inclusion of minority- and women-owned fund managers managing funds for SRPS. GOMA requested that the Regional Economic Studies Institute (RESI) of Towson University assist them in producing this report, which is limited by SB779 to evaluating SRPS.[4]

Pursuant to SB 779, RESI conducted this study of the SRPS and all funds managed by the Board of Trustees for the SRPS to fulfill the following objectives:

1. To determine the capacity of SRPS to select minority fund managers across all asset classes consistent with the fiduciary responsibilities of the Investment Division of the Maryland State Retirement Agency (MSRA); and
2. To determine methods that best assure the recruitment and selection of minority companies for fund-to-fund management or direct management by the Investment Division of the MSRA that are consistent with its fiduciary responsibilities.[5]

SRPS is led by the fourteen members of its Board of Trustees, who are responsible for administering the State's retirement and pension system. The members of the Board of Trustees act as fiduciaries of the system, which requires the Trustees to invest in a "prudent fashion and solely for the benefit of members and beneficiaries."[6] One of the vital goals for the SRPS's

[1] Maryland General Assembly, Department of Legislative Services, 2008 Session, *SB 606, State Government – Brokerage and Investment Management Services – Use of Minority Business Enterprises,* [introduced to Maryland General Assembly; 29 February 2008] 2008 Session, codified under chapter 600, Fiscal Policy Note.
[2] Ibid.
[3] Ibid.
[4] Maryland General Assembly, Department of Legislative Services, 2012 Session, *SB 779, State Retirement and Pension System – Study of Asset Management,* [effective 1 July 2012] 2012 Session, Fiscal Policy Note.
[5] Ibid.
[6] Maryland General Assembly, Department of Legislative Services, 2008 Session, *SB 606, State Government – Brokerage and Investment Management Services – Use of Minority Business Enterprises,* [introduced to Maryland General Assembly; 29 February 2008] 2008 Session, codified under chapter 600, Fiscal Policy Note.

operations is to "prudently invest system assets in a well-diversified manner that optimizes long-term returns while controlling risk."[7]

In 2007, the Board of Trustees approved the creation of the Emerging Managers Program to help invest a "portion of the system's assets with small and minority-owned investment managers."[8] The program is now titled the Terra Maria program. The program included nine investment managers and a total portfolio of $368 million, or roughly 0.9 percent of SRPS's total assets. The initial ten emerging managers of the program, seven of which were minority-owned businesses, outperformed the S&P 500 benchmark and, when SB 606 passed the following year, the Board set out to expand the program the following year. RESI found that, since the passing of SB 606, SRPS has continued to expand the Terra Maria program, leading to tremendous gains in the inclusion of minority- and woman-owned investment management and brokerage firms.[9]

To ensure that SRPS upholds its fiduciary responsibilities while including minority- and woman-owned firms, the Terra Maria program involves seven program managers that become fiduciaries of the system and therefore have specific responsibilities. Those responsibilities include serving as extensions of SRPS staff, sourcing investment managers, performing due diligence, monitoring managers' performance, preparing "hire/fire" recommendations for the CIO, and funding recommended investments.[10] Maryland Code dictates that, if a fiduciary of the system does not have the skills or capacity to carry out certain duties, the fiduciary should hire the services of a more skilled consultant or external manager. That consultant or external investment managers then becomes a fiduciary of the system.[11]

SRPS, being a public pension plan, is not subject to the fiduciary standards outlined in the Employee Retirement Income Security Act of Title 29 in the United States Code. However, a similar set of fiduciary standards by which to invest these assets has been in Maryland law since the 1950s and were incorporated into the legal standards of the Investment Policy Manual in 2002:

- "For the exclusive purposes of providing benefits to participants and for reasonable expenses of administering the several systems [also known as the "Exclusive Benefit Rule"];
- With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- By diversifying the investments of the System so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

[7] "Investment Policy Manual," *State Retirement and Pension System of Maryland State Retirement Agency*, August 2006, accessed October 2012.
[8] Maryland State Retirement and Pension System, *Terra Maria: Developing Manager Program in Public Markets and Private Equity*, February 2011, Accessed 26 July 2012.
[9] Ibid.
[10] Ibid.
[11] *Duties and Responsibilities of Trustees*, Maryland Code, Title 21, Ch. 6, §2 (1957), §1-204.

- In accordance with the laws, documents and instruments governing the several systems."[12]

While it is the duty of the Trustees to manage the assets invested by SRPS, one "may allocate fiduciary responsibilities among fiduciaries" or "designate persons other than themselves to carry out fiduciary responsibilities" as SRPS does with its consultants and external investment managers.[13]

Due to the exclusive benefit rule, it is prohibited for a fiduciary to

- "Have any direct interest in the gains or profits of any investment made by the System;
- Directly or indirectly, for himself or as an agent, in any manner use the gains or profits of the System except to make such current and necessary payments as are authorized by the Board of Trustees (SPP Section 21-202);
- Become an endorser or surety, or in any manner an obligor, for money loaned to or borrowed from the System (SPP Section 21-205(4));
- Deal with the assets of the System in his own interest or for his own account (SPP Section 21-205(1));
- In his individual or in any other capacity act in any transaction involving the System on behalf of a party (or represent a party) whose interests are adverse to the interests of the System or the interests of its participants (SPP Section 21-205(2));
- Receive any consideration for his own personal account from any person dealing with the System in connection with a transaction involving the assets of the System (SPP Section 21-205(3))."[14]

Considering the above statutes and requirements outlined in SRPS's investment policy and of SB 606, this report seeks to answer the following question:

> "What are the best practices for selection and utilization of minority- and woman-owned investment management firms, and has the State Retirement and Pension System of Maryland successfully executed these practices?"

To answer that question, RESI employed a variety of research methodologies from interviewing State retirement officials and/or minority business fund managers to examining other states and their practices.

3.0 Findings

RESI reviewed relevant policy notes, Maryland's and other state codes, various state pensions' policy manuals and comprehensive annual reports, and a number of emerging manager programs' reports (please refer to the full list of references in Section 5.0). The literature review

[12] "Investment Policy Manual," *State Retirement and Pension System of Maryland State Retirement Agency*, August 2006, accessed October 2012.
[13] "Investment Policy Manual," *State Retirement and Pension System of Maryland State Retirement Agency*, August 2006, accessed October 2012.
[14] Ibid.

analyzes the current status of minority fund managers' opportunities for contracts with SRPS, what kind of standards fund managers face to receive contracts, and the general capacity of SRPS staff to build relationships with minority investment brokers and managers in comparison with other states. The central purpose of the literature review was to discover and compare best practices of other states' pension funds to the practices of Maryland's State Retirement and Pension System (SRPS).

RESI conducted interviews via meetings and conference calls with SRPS, members of the SRPS Investment Board, minority business fund managers, legislators, and other related entities. With input from GOMA, RESI developed interview questions to facilitate the collection of information regarding the asset management practices of Maryland's SRPS as they relate to minority- and women-owned business inclusion. Those questions are outlined in Appendix A. RESI's findings are organized by type of interviewee. A full list of interviewees can be found in Appendix B.

Findings from the literature review are compared to the opinions and information derived from RESI's personal communication with SRPS staff, Terra Maria program managers, emerging and minority- and woman-owned investment management firms, and other stakeholders of the industry and the State.

3.1 Outreach by Internal Staff

In an interview, SRPS specified its best practices including up-to-date website access to vendor opportunities, manager questionnaires, and SRPS contact information; detailed reporting structure; active searches and due diligence for firms; participation in the institutional investment industry (such as the National Association of Securities Professionals); and a structured emerging manager program, the Terra Maria program. Most importantly, all parties involved in the outreach to investment managers use race- and gender-neutral terms. It was also noted that existing minority firms have a number of alternative routes, not all of which were found in the literature review, by which to communicate their strategies to SRPS including but not limited to questionnaires, professional meetings, conferences, presentations, dedicated websites, and relevant white papers or firm research.

After review of other pension plans, RESI found that SRPS struggles with direct communication and relationship building with minority and women-owned firms in comparison to other states. New York and Illinois hosted meetings or conferences to build relationships with minority managers and brokers. In both states, time was set aside on a monthly or annual basis to meet with minority managers. For example, in Illinois the first Thursday of every month is set aside for staff to meet with emerging investment managers[15]. The New York State Teachers Retirement System (NYSTRS) held its fourth annual emerging manager conference in February 2011.

[15] William R. Atwood, "Report on Emerging Money Managers (Public Act 96-0006)," Illinois State Board of Investment, 19 December 2011, Accessed via web, 25 July 2012.

SRPS did report attending conferences including the annual Opal Emerging Manager Conference, program manager conferences, Women's Private Equity Summit, Maryland Legislative Black Caucus Investment Workshop, and the Robert Toigo Foundation's Annual Event. However, SRPS has not hosted any conferences of its own. In addition, according to representation of the Baltimore-Washington Chapter President of the National Association of Securities Professionals, since the departure of former chief investment officer (CIO) Mansco Perry, SRPS staff has attended only two conferences. The 2011 conference conflicted with SRPS's schedule, but they did attend the most recent conference in September of 2012 to notify attendees of expected changes in the structure of the Terra Maria program. However, SRPS staff report attending NASP meetings in 2010, 2011, and 2012.

When asked about opinions as to whether SRPS treats firms less favorably based on race, ethnicity, or gender, interviewees felt that the lack of communication between SRPS and potential investment managers creates an unwelcoming environment that is not open to discussion with certain groups or fund managers. Other interviewees felt that SRPS's weaknesses in selection of minority managers are a smaller part of a larger industry issue in awareness and selection of emerging and smaller firms. Some interviewees expressed the opinion that the racial, ethnic, and gender make-up of the firms used by SRPS should be representative of the population of its participants and beneficiaries.

To outside parties, the general guidelines and terms for minority firm inclusion by the SRPS are unclear, which is compounded by the lack of dialog between SRPS staff and potential firms. The dialog with SRPS staff appears to be blocked by what is referred to by some interviewees as the "gatekeepers," or investment consultants, who may or may not recommend a minority manager. Furthermore, interviewees observed a strong correlation between the existence of legislation and the inclusion of minority firms when comparing SRPS to other state pensions. The correlation being that the introduction of legislation and specific mandates on inclusion of minority-owned investment management firms has led to an increase in minority inclusion in states such as Illinois, California, and Maryland.

SRPS's lack of attendance or hosting of industry conferences creates a lost opportunity to expand its outreach efforts. This is demonstrated through the outcomes observed by NYSTR as a result of its outreach event. NYSTRS's stated a goal for its emerging manager conference "to introduce minority and women-owned business enterprise investment managers and brokers to NYSTRS and its investment staff."[16] Emails to database contacts for registration began in January 2011, but those contacts also generated numerous inquiries about the conference from firms outside New York's database at the time. The end result was 244 people (mainly interested in public equities, private equity, fixed income, and real estate) registering for the conference and 215 people ultimately attending the conference in February.[17] As a result of effective use of databases and connections, NYSTRS's was able to reach a number of new and potential investment managers that will diversify its external staff.

[16] New York State Teachers Retirement System, *Minority and Women-Owned Business Enterprises (MWBE) Asset Management and Financial Institution Strategy Report for the 2010-11 Fiscal Year,* New York, 1 September 2011, Accessed via Web, 25 July 2012.
[17] Ibid.

Based on interviews with program managers, emerging managers, and other stakeholders, RESI found a common theme of emerging managers having to build relationships with fund-of-fund managers or plan sponsors over a number of years before receiving any allocation of funds. While the Terra Maria program has grown rapidly, it's inclusion of small, minority-owned firms has remained limited due to a lack of accessibility outside of relationships with fund-of-fund managers.

Accessibility of the system is a key factor in outreach because, once the system is able to assess the availability of minority firms through databases or other inquiries, the system should then open a relationship with those firms via forums, meetings, conferences, or questionnaires that allow the minority firms to display their abilities and strategies as they fit to the system. While minority- and woman-owned managers who had existing relationships with program managers before gaining SRPS as a client feel that communication with Investment Division staff was fair, other managers did not have the same experience. Interviews with persons outside of SRPS revealed that managers without an existing connection to SRPS, either directly or through external staff, did not have the same smooth experience attempting to communicate with Investment Division staff.

3.2 Role of External Staff and Consultants

SRPS stated that they use consultants for the purpose of vetting and recommending firms to the CIO. All hired external managers and consultants agree to be fiduciaries of the system. External manager contracts typically cover no more than five years. Termination or retaining of managers is based on performance as well as adherence to the fiduciary duties outlined in the Maryland Code and investment policy of the System, or, in general, on each manager's realized performance, investment strategy, and the investment team's capacity to deliver the chosen strategy. Performance of investment managers is tracked and reported on a quarterly and monthly basis by program managers who are responsible for managing investment managers within the Terra Maria program. SRPS noted that brokers are not selected directly by SRPS internal staff or consultants but by the investment managers and are therefore not subject to the same vetting, hiring, and firing process of the Investment Division.

When looking at the practices of other emerging manager programs, databases have proven to be an effective tool to build contacts for outreach events. In Maryland, SRPS's external consultants use large and detailed databases similar to those used by other states as well as assisting SRPS staff with due diligence and manager monitoring. Altius Associates is also responsible for assisting SRPS staff with due diligence and manager monitoring. Altius is the investment consultant used by SRPS for the creation and maintenance of a database of all investment managers to follow manager activity and progress over time to maintain an understanding of each manager's capabilities and to identify potential new managers. Any recommendation by the investment consultant must also be supported and made by internal staff to the CIO.

In a follow-up interview with SRPS staff, it was noted that its investment consultant, Altius Associates, currently uses information gained from attendance of conferences and meetings to update a growing database of private equity managers who offer diversity to the fund. This is

important as SRPS has plans to move allocation targets away from public equities, a move that is concerning to non-SRPS interviewees as they have observed little to no growth in minority firms investing in other markets. General opinions are that the move toward private markets shows a lack of sensitivity toward minority fund managers.

The focus on private equity is in line with the industry as a few interviewees noted, to generate higher returns. The availability of minority-owned private equity management firms is relatively small in comparison to firms in the public markets.
The Employees' Retirement System (ERS) of Texas only recently launched its emerging manager program in FY 2010, reporting an initial commitment of $553 million (10 percent) of the total externally advised assets to its emerging manager program. [18] Similar to Maryland's program, the ERS of Texas program's managers-of-managers are minority-owned as are many of the emerging managers. In FY 2011, Texas provided a detailed account of how ERS staff employed three outreach methods (accepting questionnaires, maintaining a database, and attending conferences) effectively by applying technology and external consultation to fill in the gaps within the state's internal staff, or to add to internal outreach efforts. The ERS moved quickly and effectively to obtain emerging managers using aggressive methods, such as the following:

- Creating a committed website and portal for all managers to register with ERS of Texas,
- Providing on the website unique questionnaires based on five asset classes,
- Maintaining a database that is updated as managers register online, and
- Attending industry conferences regularly to meet emerging managers.[19]

ERS staff is able to update and access the manager database, and managers can access it as well as upload marketing materials and firm statistics to help improve their potential for opportunities with Texas. Texas credits its experienced minority-owned managers-of-managers (what Maryland refers to as "program managers") as effective resources for building relationships with smaller minority investment firms. ERS staff attended numerous conferences and forums hosted by diverse groups from the investment community. Texas also noted plans to host its own conference in the future by creating partnerships with advocates for minority firms within the industry. [20]

Illinois hired a consultant to build and maintain a database of minority investment firms that meet their minimum criteria. Again, Texas ERS set an example for how to use a database effectively. Texas also hired a consultant to assist in locating and registering minority managers to the database, and performance of the registered investment managers is set to be tracked for at least five years to maintain "a constant dialog" between minority managers and ERS staff.[21]

[18] Employees Retirement System of Texas, *ERS Emerging Manager Program Report to the 82nd Texas Legislature*, Texas (May 2011), Accessed via web, 27 July 2012.
[19] Ibid.
[20] Ibid.
[21] Ibid.

3.3 Application, Evaluation, and Approval

It is vital to clarify that while the statute's language requires SRPS to act in a manner consistent with the minority business purchasing standards of the State, the statute does not make SRPS's procurement of brokerage and investment management services subject to the Maryland MBE Program's statutory provisions. This includes the application of MBE contract goals and the requirement that minority owned firms be subjected to the State's certification process that evaluates the ownership status of minority firms.

Under SB 606, a qualifying minority firm is a firm that is:

- "a legal entity, other than a joint venture, that is organized to engage in commercial transactions;
- at least 51 percent owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it."[22]

Firms do not need to meet the business size or personal net worth caps established for Maryland's MBE Program. Groups considered socially and economically disadvantaged include those falling under the following categories:

- African American,
- Native American,
- Asian American,
- Hispanic American, and
- Female.[23]

Documentation about SRPS's Terra Maria program states that, while program managers are aware that the focus remains on small businesses, no defined maximum is set for assets under management when recommending investment managers to SRPS. Firms are selected primarily based on potential alpha generation or performance.[24] SRPS requires a proven track record that shows performance up to par with the Investment Division's chosen benchmarks for each asset class. Benchmarks for each asset class are provided in the Investment Policy Manual, but a specific performance measurement used for individual fund managers is not disclosed under the section discussing manager retention and monitoring policies. According to SRPS, performance benchmarks are agreed upon by the investment manager and SRPS staff. SRPS considers this approach advantageous to investment managers as it allows performance measurements to be tailored to specific products.

[22] Maryland General Assembly, Department of Legislative Services, 2008 Session, *SB 606, State Government – Brokerage and Investment Management Services – Use of Minority Business Enterprises*, [introduced to Maryland General Assembly; 29 February 2008] 2008 Session, codified under chapter 600, Fiscal Policy Note.
[23] "MBE/DBE/ACDBE eligibility standards can be broken down into five key standards", *MDOT's Office of Minority Business Enterprise (OMBE) Overview*.
[24] Maryland State Retirement and Pension System, *Terra Maria: Developing Manager Program in Public Markets and Private Equity*, February 2011, Accessed 26 July 2012.

SB 606 suggests that SRPS consider the selection of minority fund managers based on the board's fiduciary responsibilities in order for the bill's provisions to have only nonnegative effects on SRPS's investment returns in the long term, meaning the policy should only maintain or improve the performance of investments for SRPS as opposed to creating a decline in returns or greater exposure to risk. Therefore, minority businesses participating in investment management for the SRPS are vetted for minority ownership status and performance history by Investment Division staff and consultants, and then recommended to the Chief Investment Officer (CIO). The CIO is ultimately responsible for hiring and firing of investment managers and brokers based on staff recommendations and adherence to fiduciary standards.[25] Brokers, however, are chosen at the discretion of the investment managers. The CIO and Investment Division staff may recommend brokers to SRPS's external fund managers, but does not mandate the use of minority brokers by their external fund managers.

The implementation of SB606 policy has allowed for minority- and woman-owned firms to gain opportunities that would not have been available otherwise. Treatment toward and growth of investment managers, once hired by SRPS, has been perceived to be fair by most interviewed managers, but comments by other managers indicate the need for clarity of SRPS's performance requirements for receipt of additional allocations or for graduation. An observation by one of the interviewees outside SRPS was that the hands-on approach of the Investment Division leads to the addition of extra responsibility to the existing staff. Entrusting more responsibility or vetting of managers to its consultants and program managers may increase the overall staff's capacity to identify and select minority managers, especially in the private markets where minority inclusion is particularly lacking.

SRPS reported to RESI in a follow-up questionnaire that there are two key Investment Division staff classifications, a managing director and a senior analyst. The managing director is responsible for establishing overall strategic investment goals, standards, and controls. The managing director ensures integrity of the investment framework, provides direct leadership, and identifies any vulnerability. The senior analyst prepares and presents data and research, participates in industry groups, assists the CIO with strategic planning, and represents the State Retirement Agency at external events.

The managing director, senior analysts, and other Investment Division staff meet with and evaluate managers on quarterly, monthly, and semiannual bases, and require that investment managers report any significant changes in ownership, litigation, assets under management, and investment strategy. SRPS reported the following specific factors as contributing to rejection or a firm not being hired in the first place:

- The strategy or type of investment is already fully represented elsewhere in the portfolio,
- The risk/reward profile is not appropriate for the portfolio,
- The manager does not excel in the strategy that SRPS needs for the portfolio,

[25] Maryland General Assembly, Department of Legislative Services, 2008 Session, *SB 606, State Government – Brokerage and Investment Management Services – Use of Minority Business Enterprises,* [introduced to Maryland General Assembly; 29 February 2008] 2008 Session, codified under chapter 600, Fiscal Policy Note, Accessed 2 August 2012.

- The manager does not have adequate capacity in the regions its strategy covers,
- The managers fees are too high, and/or
- SRPS is unable to successfully negotiate terms with the manager/fund.

SRPS has two paramount and required fiduciary duties set forth by the Investment Policy Manual of the Investment Division and the Maryland Code. The required duties are well summarized by the Exclusive Benefit Rule—Fiduciaries of an employee pension must act "for the exclusive purposes of providing (1) benefits to the participants and (2) reasonable expenses of administering the several systems."[26] Arguably, SRPS's required fiduciary duties create a challenge in terms of pursuing other objectives such as the inclusion of small and minority brokerage and investment management firms over the years. However, based on GOMA's first report on minority investment manager and broker utilization in FY 2009, following SB 606's passing in 2008, inclusion of minority firms jumped from 7 in 2008 to 45 in 2009 (a 542.9 percent increase).[27] Much of that increase can be attributed to SB 606 and SRPS's outreach efforts to expand the Terra Maria program.

Conferences, databases, and questionnaires were commonly used methods to help increase the number of applications from minority managers into a number of states' pension systems and emerging manager programs, including SRPS and the Terra Maria program. Based on interviews with three of the program managers SRPS placed inquiries through industry publications and through its external consultants to find six new program managers to expand its emerging manager program in late 2008. Program managers filled out questionnaires, proposals, and met with Investment Division staff on a number of occasions in order to receive funds from SRPS.

Minority- and woman-owned fund managers from the Terra Maria program also informed RESI that questionnaires, quarterly and annual reports, and calls or meetings were completed in order to receive and retain funds from their respective program managers. Despite SRPS's external consultants and program managers handling of due diligence or outreach efforts, SRPS staff often participates in due diligence to ensure that all external staff are compliant with fiduciary duties. In fact, one minority portfolio manager characterized a recent conversation with an Investment Division staff member as "insightful and searching." The conversation was part of a biannual meeting performed by SRPS staff to check on the performance of its fund managers. The manager also noted that no program manager was present, allowing for a one-on-one interview directly with Investment Division staff, who asked searching questions that did not allow for the fund manager to "skate" through the interview.

3.4 Utilization

As stated previously, Maryland created an emerging manager program in 2007 that was renamed the Terra Maria program after its initial success in 2008. Similar to other states' emerging manager programs, Terra Maria focuses on assisting small and minority businesses in acquiring contracts to manage investments for public funds. The purpose of the program is to "diversify the

[26] *Standards of Care,* Maryland Code, Title 21, Ch. 6, §2 (1957), §1-203.
[27] Zanes Cypress, *Report on the Usage of Minority and Women-Owned Brokerage and Investment Management Firms by the State of Maryland,* Governor's Office of Minority Affairs, Fiscal Year 2009.

System's manager base, generate after-fee returns greater than a passive alternative and provide strong risk management."[28]

Maryland's SRPS had only seven minority firms managing $326.5 million in assets (representing 0.9 percent of the total portfolio) in FY 2008. In FY 2011, SRPS had 61 minority investment managers handling $4.1 billion (or 10.9 percent) of the total $37.5 billion portfolio. These numbers represent a 1,155.7 percent increase in minority-managed investments since the passing of SB 606 in 2008.[29] SRPS used 55 (or 15.4 percent) of the total investment brokers, whose total commissions were $1.6 million in FY 2011, representing an approximate increase of 57.1 percent minority brokers used since 2010.[30] [31] GOMA indicated that data on SRPS utilization of investment brokers was not available until 2010 in response to GOMA's primary recommendation for state agencies to provide more transparent broker information. Figure 1 shows the progress of SRPS's inclusion of minority- and woman-owned investment management firms since the passing of SB 606.

Figure 1: SRPS Minority- and Woman-Owned Firms, FY 2008 – FY 2011

SRPS	FY 2008	FY 2009	FY 2010	FY 2011
Minority-owned investment firms (#)	7.0	45.0	53.0	61.0
Minority managed assets ($millions)	$326.50	$1,253.40	$2,906.40	$4,099.80
Total portfolio assets ($millions)	$36,595.70	$28,530.90	$31,840.90	$37,508.40
Minority managed assets (%)	0.9%	4.4%	9.1%	10.9%
Year-over-year change (basis points)	-	3.5	4.7	1.8

Source: GOMA, RESI, SRPS

Figure 1 indicates that, while the overall increase in the percentage share of the portfolio's assets being allocated to minority-owned firms between FY 2008 and FY 2011 has been great (a 1,157.7 percent increase), the year-over-year change in the percentage share of assets for minority-owned firms has begun to decline. There are a number of potential reasons contributing to this decline, as described below.

a) The universe of domestic minority- and woman-owned managers is relatively small within the industry and

[28] Maryland State Retirement Agency, *Comprehensive Annual Financial Report 2008,* Maryland State Retirement and Pension System, June 30, 2008.
[29] "Utilization Data Comparison 2008 thru 2011," Government Office of Minority Affairs, *E-mail,* Accessed 31 July 2012.
[30] Zanes Cypress, *Report on the Usage of Minority and Women-Owned Brokerage and Investment Management Firms by the State of Maryland,* Governor's Office of Minority Affairs, Fiscal Year 2009.
[31] Maryland State Retirement Agency, *Comprehensive Annual Financial Report 2008,* Maryland State Retirement and Pension System, June 30, 2008.

b) The internal and external staff may not currently have the capacity to take on additional investment managers without the addition of new program managers or staff to manage new mandates.

According to SRPS and GOMA's annual reports, managers in Terra Maria are generally given at least $10 million in assets under management (AUM), which is higher than the typical AUM allocated to emerging managers in other emerging manager programs. In Texas, managers of emerging managers (what SRPS calls program managers) of all asset classes were allocated approximately $50 million each to be distributed to five to ten emerging managers. If distributed evenly, emerging managers in Texas' program receive a maximum allocation of $10 million, as opposed to the maximum allocation of over $100 million to emerging managers by SRPS. The Terra Maria program also includes private funds that are typically up to $500 million, with overall manager AUM up to $2 billion.

As noted earlier, to ensure that SRPS upholds its fiduciary responsibilities while including minority- and woman-owned firms, the Terra Maria program involves seven external program managers that become fiduciaries of the system and serve as extensions of SRPS staff assisting SRPS in identifying, vetting, and monitoring investment managers. SRPS hired all program managers through a competitive request for proposal (RFP) process involving onsite visits by the CIO and Investment Division staff for vetting of each fund-of-funds manager.

Northern Trust Global Advisors, a nonminority firm, was hired by SRPS through a competitive RFP process to kick off the Terra Maria program in April 2007. In FY 2008, Northern Trust Global Advisors began its first full fiscal year in the Terra Maria program with seven minority investment managers out of ten total emerging managers.[32] Those ten emerging managers exceeded the program's performance benchmark by four percentage points that year, and the program was expanded to 7 program managers who were allocating funds to 45 emerging minority- and woman-owned investment management firms in FY 2009.

All six of the new program managers in FY 2009 are minority- or woman-owned firms, four of which are African-American, one of which is woman-owned, and one of which is both African-American and woman-owned. This demonstrates that, once the Terra Maria program was expanded through SRPS's efforts to comply with the legislative mandate of SB 606, utilization of minority investment managers increased significantly. The demographic makeup of the Terra Maria program managers is shown in Figure 2 below.

[32] Maryland State Retirement Agency, *Comprehensive Annual Financial Report 2008*, Maryland State Retirement and Pension System, June 30, 2008.

Figure 2: Terra Maria Program Managers by Minority Status, FY 2009 – FY 2011

Minority Status	Number[33]
Minority	**6.0**
African-American	4.5
Asian-American	-
Hispanic/Latino	-
Native American	-
Woman	1.5
Nonminority	**1.0**

Sources: GOMA, RESI, SRPS

In the literature review, RESI found that the specific requirements for firms to be classified as an emerging investment manager vary and depend on the plan sponsor and its overarching investment goals. SRPS defines an emerging manager as a qualifying firm "with total assets under management of at least $10 million but less than $2 billion." SRPS defines an emerged investment manager as a qualifying firm "with total assets under management of more than $2 billion."[34] The number, classification, and AUM for minority fund managers, separated by emerging or emerged status, in FY 2011 are shown in Figure 3 below.

Figure 3: Utilization of Minority Managers by Classification, FY 2011

Investment Managers	Classification	Asset Class	FY 2011 ($ million)
Total Emerging	**36**		**$1,464.80**
Charter Financial Group	Woman	U.S. Equity	10.80
Apex Capital Management	Asian American	Int'l Equity	11.10
Seacrest Investment Management	Asian American, Hispanic American	U.S. Equity	15.70
Opus Capital Management	African American, Woman	U.S. Equity	16.40
Hughes Capital Management	African American	Fixed Income	17.90
Mar Vista Investment Partners	African American	U.S. Equity	18.40
Phocas Financial Corp	Asian American	U.S. Equity	18.50
Xavier Capital Management	African American	Credit	20.40
AH Lisanti Capital Growth	Woman	U.S.	21.10

[33] One of the program managers, FIS Group, are classified as both African-American and Woman-owned, so each classification was weighted as 0.5 to accurately represent the distribution of minority and woman ownership for FIS Group.

[34] Maryland State Retirement and Pension System Board of Trustees, *Minority Owned Financial Services Firm Usage: Annual Report Questionnaire Fiscal Year 2011*, Submitted to Governor's Office of Minority Affairs, 31 August 2011.

Investment Managers	Classification	Asset Class	FY 2011 ($ million)
		Equity	
Holt-Smith Advisors	Woman	U.S. Equity	26.90
Victoria 1522 Investments	Asian American, Woman	Int'l Equity	27.00
The Edgar Lomax Company	African American	U.S. Equity	27.40
Cheswold Lane Asset Management	Woman	Int'l Equity	30.00
Decatur Capital Management	African American	U.S. Equity	30.60
Hanseatic Management Services	Woman	U.S. Equity	30.60
Ativo Capital Management	Hispanic American	Int'l Equity	31.30
Strategic Global Advisors	Woman	Int'l Equity	31.60
Nicholas Investment Partners	Woman	Credit	32.10
Lesa Sroufe & Co.	Woman	U.S. Equity	36.60
Hanoverian Capital Management	Woman	Int'l Equity	36.70
Affinity Investment Advisors	Asian American	U.S. Equity	37.40
Greenfield Seitz Capital Management	Woman	Global Equity	40.30
San Juan Asset Management	Hispanic American	Global Equity	40.40
Channing Capital Management	African American	U.S. Equity	43.40
Paradigm Asset Management	African American	Int'l Equity	43.40
Palisades Investment Partners	African American	U.S. Equity	44.10
Redwood Investments	Woman	U.S. Equity	46.10
John HSU Capital Group	Asian American	Global Equity	49.80
Ambassador Capital Management	African American	Fixed Income	60.20
Boston Common Asset Management	Asian American, Woman	Int'l Equity	63.90
Longitude Venture Partners	Woman	Private	65.00

Investment Managers	Classification	Asset Class	FY 2011 ($ million)
		Equity	
ARGA Investment Management	Asian American	Int'l and Global Equity	71.74
Profit Investment Management	African American	U.S. Equity	83.70
Pugh Capital Management	African American, Woman	Fixed Income	85.80
Credo Capital Management	African American	U.S. Equity	88.70
New Century Advisors	Woman	Fixed Income	110.10
Total Emerged	**25**		**$2,635.00**
GW Capital, Inc.	Asian American	U.S. Equity	11.40
New Amsterdam Partners	Woman	U.S. Equity	12.00
Sit Investment Associates	Asian American	Int'l Equity	14.40
LM Capital Group	Hispanic American	Fixed Income	20.20
GlobeFlex Capital	Woman	Int'l Equity	21.50
Advent Capital Management	African American	Credit	23.00
Lombardia Capital Partners	Hispanic American	Int'l and U.S. Equity	28.70
Piedmont Investment Advisors	African American	Fixed Income	30.00
Ariel Investments	African American	U.S. Equity	33.00
Longfellow Investment Management	Woman	Fixed Income	35.80
Penn Capital Management	Woman	Credit	36.90
Sky Investment Council	Asian American, Woman	Int'l Equity	48.20
Garcia Hamilton	Hispanic American	Fixed Income	63.90
Westwood Global Investments	Woman	Int'l Equity	78.00
Herndon Capital Management	African American	Int'l and U.S. Equity	84.30

Investment Managers	Classification	Asset Class	FY 2011 ($ million)
Tortoise Capital	Native American	Master Limited Partnership	84.90
Asia Alternatives	Asian American, Woman	Private Equity	200.00
Zevenbergen Capital Investments	Woman	U.S. Equity	256.10
Earnest Partners	African American	Int'l Equity	406.40
Rock Creek Potomac Fund	Woman	Absolute Return	421.80
Brown Capital Management	African American	Int'l and Global Equity	449.50
Advent Legacy Securities & Wellington Asset Management	African American	Credit	75.00
Blaylock Robert Van & Marathon Asset Management	African American	Credit	50.00
Castle Oak Securities & Park Madison Partners & Angelo Gordon	African American	Credit	50.00
RLJ & Western Asset Management	African American	Credit	100.00
Total Minority	***61***		***$4,099.80***

Sources: GOMA, RESI, SRPS

As of FY 2011, Maryland's SRPS has 116 investment managers from the Terra Maria program, 36 of which are minority fund managers allocated a total of $1,465 million, representing 4 percent of the total $37,508 million portfolio and 49 percent of the total $3,300 million Terra Maria funds. Ten of the Terra Maria emerging managers were Maryland-based and held a total of $339 million, or 0.06 percent of the portfolio's total assets (10.3 percent of total assets for emerging managers). Two of the 25 Terra Maria emerged managers were Maryland-based and held $566 million of the fund's assets, or 1.51 percent of the portfolio's total assets.[35]

The demographics of minority managers utilized by SRPS are shown in Figures 4 and 5 below for both emerging and emerged managers. Data for years prior to FY 2009 are not shown as the number of minority managers utilized before the passing of SB 606 was negligible.

[35] Maryland State Retirement and Pension System Board of Trustees, *Minority Owned Financial Services Firm Usage: Annual Report Questionnaire Fiscal Year 2011*, Submitted to Governor's Office of Minority Affairs, 31 August 2011.

Figure 4: Demographics of Emerging Managers by Classification, FY 2009 – FY 2011

Classification	% FY 09	% FY 10	% FY 11
Total Minority	**39.6%**	**36.7%**	**37.9%**
African-American	39.5%	34.7%	33.3%
Asian-American	14.5%	15.3%	18.1%
Hispanic/Latino	3.9%	6.9%%	6.9%
Native American	2.6%	2.8%	0.0%
Woman	39.5%	37.5%	41.7%
Total Nonminority	**60.4%**	**63.3%**	**62.1%**
Total Minority-Owned Emerging	***38***	***36***	***36***
Total Emerging	***96***	***98***	***95***

Sources: GOMA, RESI, SRPS

Figure 4 shows that 40 percent of emerging managers in the Terra Maria program are minority- or woman-owned. African-American firms have represented between 33 and 40 percent of emerging firms at SRPS. Woman-owned firms represent the highest number of emerging minority managers at 42 percent; however, several woman-owned firms are also representative of firms under a separate minority ownership classification. Therefore, it would not be accurate to assume that all woman-owned emerging firms are solely representative of nonminority female ownership. For example, Pugh Capital is both African-American- and woman-owned, and Boston Common Asset Management is both Asian-American- and woman-owned.

Figure 5: Demographics of Emerged Managers by Classification, FY 2009 – FY 2011

Classification	% FY 09	% FY 10	% FY 11
African-American	50.0%	52.9%	40.0%
Asian-American	0.0%	5.9%	12.0%
Hispanic/Latino	25.0%	5.9%	12.0%
Native American	0.0%	5.9%	4.0%
Woman	25.0%	29.4%	32.0%
Total Minority-Owned Emerged	***4***	***17***	***25***

Sources: GOMA, RESI, SRPS

African-American owned firms represent 33 percent of emerging managers, and 40 percent of emerged managers (those who were allocated extra funds through separate mandates). Asian-American owned firms represent 18 percent of emerging managers and 12 percent of emerged managers. Hispanic and Latino-owned firms represent 7 percent of emerging managers and 12 percent of emerged managers. Native American firms are only represented in the emerged manager category, comprising 4 percent of the total. Notably, Asian-, Hispanic- and women-owned firms saw an increase in representation between FY 2009 and FY 2011, while representation of African-American- and Native American-owned firms dropped. Among emerged managers, Asian-, Native-American- and women-owned firms saw a growth in representation while representation of African-American- and Hispanic-owned firms dropped.

Figure 6 displays the distribution of allocated funds by minority status within the Terra Maria program. Total allocations are in millions of dollars.

Figure 6: Allocations to Emerging Managers, FY 2009 – FY 2011

Minority Status	FY 09		FY 10		FY 11	
	$ millions	%	$ millions	%	$ millions	%
Minority	1,078.10	55.6%	1,248.60	49.0%	1,464.8	44.4%
African-American	456.45	23.5%	492.55	19.3%	529.30	16.0%
Asian-American	145.10	7.5%	186.35	7.3%	241.84	7.3%
Hispanic/Latino	49.70	2.6%	92.90	3.6%	79.55	2.4%
Native American	38.10	2.0%	66.80	2.6%	-	0.0%
Woman	388.75	20.0%	410.00	16.1%	614.45	18.6%
Nonminority	861.40	44.4%	1,300.80	51.0%	1,834.76	55.6%
Total Emerging	***1,939.50***	***100.0***	***2,549.40***	***100.0***	***3,299.56***	***100.0***

Sources: GOMA, RESI, SRPS

Allocation of funds to minority managers has steadily increased since the passing of SB 606 and the expansion of the Terra Maria program. Between FY 2009 and FY 2011, the allocation of funds for all minority groups increased except for Native American-owned firms. The percentage distribution of Terra Maria funds allocated to minority-owned firms compared to allocations to nonminority firms has, however, decreased since FY 2009. It is necessary to point out that, in some cases, a decrease in funds to a particular minority group may represent the movement of firms within that group from emerging to emerged managers. Figure 7 shows allocations to emerged minority managers over the same three fiscal years shown above.

Figure 7: Allocations to Emerged Minority Managers, FY 2009 – FY 2011

Minority Status	FY 09		FY 10		FY 11	
	$ millions	%	$ millions	%	$ millions	%
African-American	30.00	16.3	1,004.20	60.6	1,301.20	49.4
Asian-American	0.00	0.0	18.00	1.1	149.90	5.7
Hispanic/Latino	19.20	10.4	21.50	1.3	112.80	4.3
Native American	0.00	0.0	63.10	3.8	84.90	3.2
Woman	135.10	73.3	551.00	33.2	986.20	37.4
Total Emerged Minority	***184.30***	***100.0***	***1,657.80***	***100.0***	***2,635.00***	***100.0***

Source: GOMA, RESI, SRPS

The number of SRPS emerged managers went from 4 in FY 2009 to 17 in FY 2010 and to 25 in FY 2011. In FY 2011, allocations to emerged minority fund managers were $2.6 billion, representing 7 percent of the total $37.5 billion pension fund. As the years progressed, small decreases can be observed in the percentage share of allocations to all minority-owned, emerging firms (shown in Figure 6) as the allocations to emerged managers of some of those same groups continued to significantly increase (shown in Figure 7). Figure 8 shows the transition from emerging to emerged status by minority group between FY 2009 and FY 2011.

Figure 8: Emerging to Emerged Managers, FY 2009 – FY 2011

Minority Status	# Firms	FY 2009	FY 2010	FY 2011
African American	2			
Emerging		$81.60	$44.20	$0.00
Emerged		$0.00	$362.70	$533.80
Asian American	1.5			
Emerging		$62.10	$64.60	$0.00
Emerged		$0.00	$0.00	$35.50
Hispanic/Latino	1			
Emerging		$75.60	$90.00	$0.00
Emerged		$0.00	$0.00	$28.70
Native American	0			
Emerging		$0.00	$0.00	$0.00
Emerged		$0.00	$0.00	$0.00
Woman	3.5			
Emerging		$95.40	$35.90	$0.00
Emerged		$0.00	$80.00	$358.20
Total	***8***			
Total Emerging		***$314.70***	***$234.70***	***$0.00***
Total Emerged		***$0.00***	***$442.70***	***$956.20***

Sources: GOMA, RESI, SRPS

Figure 8 shows a total of 8 minority- and woman-owned investment management firms that were emerging managers in FY 2009 and transitioned to emerged status by FY 2011. Figure 8 does not include any emerged manager that has been in the "emerged" category since inception of their contract with SRPS. These firms were retained by the Terra Maria program after each firm had total AUM over $2 billion. African American and woman-owned firms experienced the greatest gains after reaching emerged manager status, offsetting the loss of allocations to emerging managers in the same minority groups. Asian American and Hispanic/Latino owned firms experienced significant declines in AUM after transitioning to emerged status. Overall, the eight minority- and woman-owned firms who transitioned from emerging to emerged gained almost $650 million in AUM between FY 2009 and FY 2011.

Figure 9 displays the number of emerging fund managers terminated between FY 2009 and FY 2011 by ownership classification. RESI did not include those emerging managers who transitioned from emerging to emerged while under contract with SRPS. RESI assumed an emerging manager to be terminated if they were listed as receiving no allocation of funds, as an emerging or emerged firm, in a fiscal year following a fiscal year in which they were allocated funds by SRPS. Managers who fall under more than one ownership category are counted as a weighted portion of each qualifying classification.

Figure 9: Terminated Emerging Managers by Classification, FY 2009 – FY 2011

Classification	FY 09	FY 10	FY 11	Total
Minority	**1**	**5**	**5**	**11**
African-American	0	3.5	0	3.5
Asian-American	0	0	1	1
Hispanic/Latino	0	0	1	1
Native American	0	0	1	1
Woman	1	1.5	2	4.5
Nonminority	**0**	**4**	**10**	**14**
Terminated Managers	***1***	***9***	***15***	***25***

Sources: GOMA, RESI, SRPS

Data from annual reports by GOMA and SRPS indicate that between FY 2009 and FY 2011, at least 11 minority- or woman-owned management firms and 14 nonminority-owned firms were terminated by SRPS. A majority of minority-owned firms terminated by SRPS during this time period were either woman-owned, 5 of which were terminated, or African-American-owned, 4 of which were terminated.[36] Overall, minority- and woman-owned firms represented 44 percent of the emerging mangers terminated while nonminority-owned firms represented the other 56 percent of emerging managers terminated between FY 2009 and FY 2011.[37] [38] A majority of terminations occurred between FY 2010 and FY 2011.

Other states researched for the literature review have funded and participated in emerging manager programs that are similar in structure to Maryland's Terra Maria program. The general purpose of these programs is to increase the use of minority and emerging managers while maintaining low exposure to risk. In all cases, successful states employed aggressive marketing and outreach efforts through their websites, emails, and other publications to build awareness of opportunities for emerging and minority investment firms. Differences in programs were often in size of initial investment, capacity of the staff, and rigor of relevant investment policy.

Similar to Maryland, the State Employees' Retirement System (SERS) of Illinois has benefited from being an early adopter of state-run emerging manager programs. Illinois's emerging manager program was created in 2005, with a two- to three-year lead on Maryland's program. SERS's report to the Illinois General Assembly in 2011 stated that minority utilization goals were either met or exceeded through the use of the emerging manager program. The goal for minority utilization in Illinois was 20 percent, but actual minority investment manager allocations represented 26.9 percent of the total portfolio as of June 2011. Approximately 12.7 percent of allocations to the minority firms in Illinois were emerging.[39]

[36] Maryland State Retirement and Pension System Board of Trustees, *Minority Owned Financial Services Firm Usage: Annual Report Questionnaire*, Submitted to Governor's Office of Minority Affairs, 2008 to 2011.
[37] Ibid.
[38] Maryland State Retirement Agency, *Comprehensive Annual Financial Report,* Maryland State Retirement and Pension System, 2008 to 2011.
[39] State Employees' Retirement System of Illinois, *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011*, Illinois (2011).

For Maryland and Illinois, when comparing the diversity of program participants to the demographics of each state, minorities represented an estimated 41.4 percent of Maryland's population and 27.5 percent of Illinois's population in 2011.[40] Furthermore, data from the Census Bureau's *Survey of Business Owners* shows that approximately 19.4 percent of Maryland's firms in the finance and insurance sector are minority-owned while only 11.4 percent of Illinois' finance and insurance firms are minority-owned.[41] This demonstrates that SRPS has yet to gain a diverse group of investment managers and brokers that is representative of the state's population or of the investment firms available in Maryland.

The data in this section show that SRPS has been able to allocate a greater amount of funds to a greater amount of minority- and woman-owned firms since the passing of SB 606 in 2008, but the FY 2011 allocation of 10.9 percent of the portfolio's total funds to minorities is not yet comparable to the demographics of the State allocation target of 20 percent set by Maryland's Minority- and Women- Owned Business Enterprise Program. In addition, the allocation of funds to minority- and woman-owned firms by each minority and woman category is not comparable to the availability of those firms in Maryland. In Maryland, for example, African-American and woman-owned firms in the finance and insurance industry make up 31.7 percent and 53.3 percent, respectively, of Maryland's total minority- and woman-owned firms in the industry. In the United States, African-American and woman-owned firms in the finance and insurance industry make up 12.4 percent and 59.2 percent, respectively, of all minority- and woman-owned firms in the industry.[42]

3.5 Overall Program Goals

As previously mentioned, the overarching purpose of the Terra Maria Program is to help invest a "portion of the system's assets with small and minority-owned investment managers" while reducing risk and optimizing long-term returns.[43] Figure 10 below shows the performance benchmarks and expectations set by SRPS in the Investment Division's *Investment Policy Manual* including the customized benchmark created to gauge performance of the Terra Maria program as a whole. Custom benchmarks are specific to certain mandates or asset categories and are determined by a set of weighted industry benchmarks selected by SRPS and approved by the Board.[44]

[40] U.S. Census Bureau, "ACS Demographic and Housing Estimates, 2011 American Community Survey 1-Year Estimates (Illinois and Maryland)," *American Factfinder 2*, Accessed October 17, 2012,
[41] U.S. Census Bureau, "Table 5. Summary Statistics for Minority-Owned Firms by State and Kind of Business: 2007," *2007 Survey of Business Owners* (Released June, 7 2011).
[42] Ibid.
[43] Maryland State Retirement and Pension System, *Terra Maria: Developing Manager Program in Public Markets and Private Equity*, February 2011, Accessed 26 July 2012.
[44] Some states' emerging manager programs, such as the Chicago Teacher's Pension Fund and the Chicago Municipal Employees Fund, set numerical goals for minority managers' allocations by asset class based on data from disparity studies conducted specifically for this purpose.

Figure 10: Performance Benchmarks by Asset Class, FY 2011

Asset Class	Benchmarks Used	FY 2011 Actual Performance	FY 2011 Benchmark Performance	Excess of Benchmark
Public Equity	Custom Benchmark^	28.8%	31.7%	-2.9
U.S. Equity	S&P 500	32.4%	30.7%	1.7
	Russell 3000		32.4%	-32.4
International Equity	MSCI ACWI ex. U.S.	24.6%	29.7%	-5.1
	MSCI EAFE		30.4%	-30.4
	MSCI Emerging Markets		27.8%	-27.8
	MSCI World ex. U.S.		30.3%	-30.3
Global Equity	MSCI AC World	29.7%	30.1%	-0.4
Private Equity	Custom State Street PE	24.5%	21.9%	2.6
	Russell 3000 + 300 BPS		36.3%	-36.3
Fixed Income	Custom Benchmark^	4.8%	3.5%	1.3
	BC Aggregate		3.9%	-3.9
	BC Global Bond Agg		2.1%	-2.1
Credit/Debt Strategies	Custom Benchmark^	13.5%	10.9%	2.6
	BC Credit		6.2%	-6.2
	BC High Yield		15.6%	-15.6
Real Estate	Custom Benchmark^	23.3%	22.8%	0.5
	Wilshire RESI		35.7%	-35.7
	NCREIF		16.0%	-16.0
	FTSE EPRA NAREIT		32.1%	-32.1
Real Return	Custom Benchmark^	13.1%	11.2%	1.9
Absolute Return	Custom Benchmark^	8.5%	6.7%	1.8
Terra Maria	***Custom Benchmark^***	***29.6%***	***30.1%***	***-0.5***
Total		***20.0%***	***20.2%***	***-0.2***

Sources: RESI, SRPS

Overall, performance goals for FY 2011 for the investment program of SRPS were not met. The actual performance of the investment program was underweight in comparison to its benchmarks in FY 2011. The performance of SRPS's investments was generally contributed to the sluggish growth of the domestic economy in the last two quarters of the fiscal year as well as the various fiscal and economic crises abroad.[45] The Terra Maria program's performance in FY 2011 was

[45] Maryland State Retirement Agency, *Comprehensive Annual Financial Report 2011*, Maryland State Retirement and Pension System, June 30, 2011.

0.5 basis points below its custom benchmark, but SRPS still considered the relative performance of the program to be positive.[46]

SRPS also provided performance rates and benchmarks of a handful of minority- and woman-owned firms (please refer to Figure 11). The firms are identified only by ownership category and asset class. Some firms have more than one mandate with SRPS, so each mandate is not representative of an unduplicated firm. If the firm's inception date was within FY 2012, the 1-Year performance rate and benchmark may not represent a full year.

Figure 11: Minority- and Woman-Owned Firm Performance, FY 2012

Mandate/Asset Class (Inception Year)	Ownership	Actual 1-Year Performance ^	1-Year Benchmark Performance	Excess of Benchmark
U.S. Equity (2008)	African-American	22.7%	31.2%	-8.4
U.S. Equity (2008)	African-American	19.4%	26.7%	-7.3
U.S. Equity (2008)	African-American	29.5%	29.2%	0.3
U.S. Equity (2008)	African-American, Woman	25.5%	32.6%	-7.2
U.S. Equity (2008)	Asian-American	24.5%	32.2%	-7.6
U.S. Equity (2010)	African-American	22.8%	30.9%	-8.2
U.S. Equity (2011)	Woman	17.9%	31.1%	-13.1
Int'l Equity (2008)	Woman	18.3%	16.9%	1.3
Int'l Equity (2010)	Asian-American	20.3%	13.8%	6.5
Int'l Equity (2011)	Asian-American	27.0%	14.5%	12.5
Int'l Equity (2011)	Asian-American	15.5%	14.5%	1.0
Int'l Equity (2011)	Woman	17.4%	13.8%	3.7
Int'l Equity (2012)	Asian-American	19.2%	14.1%	5.1
Global Equity (2011)	Asian-American	18.4%	21.6%	-3.2
Fixed Income (2008)	African-American	5.9%	5.2%	0.7
Fixed Income (2008)	African-American, Woman	6.6%	5.2%	1.4
Fixed Income (2009)	Woman	6.3%	5.2%	1.1
Credit (2010)	African-American	15.3%	12.8%	2.5

Sources: RESI, SRPS

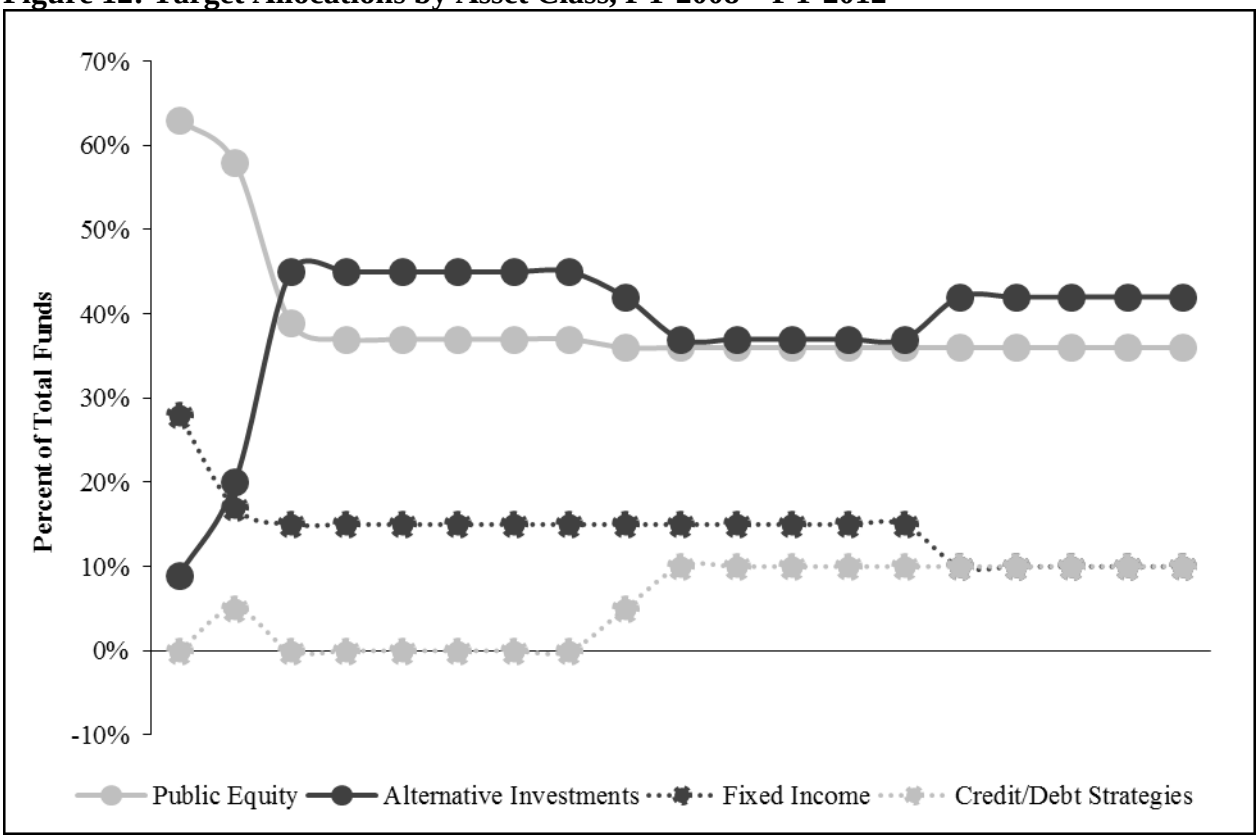
Of the mandates with performance data provided, 14 out of 18 mandates were in public equities. Of the 14 public equity mandates, half performed better than the given benchmarks, and half were underweight compared to the given benchmarks. Mandates in all other asset classes

[46] Maryland State Retirement Agency, *Comprehensive Annual Financial Report 2011*, Maryland State Retirement and Pension System, June 30, 2011.

provided performed overweight in comparison to the given benchmarks. Looking at both Figures 10 and 11, it is clear that returns from public equities have been less than expected for SRPS's investment program and the Terra Maria program. According to interviews with SRPS and its program and investment managers, the underweight performance in the public markets has been an industry-wide problem in recent years, so the industry and SRPS have been gradually investing more funds in private markets.

Figure 12 shows how SRPS has adjusted its allocation targets each quarter to respond to the changing environment within the investment industry and to external changes due to the economy and other factors.

Figure 12: Target Allocations by Asset Class, FY 2008 – FY 2012



Sources: RESI, SRPS

As shown in Figure 12, SRPS set a goal to allocate 63 percent of the total funds to be invested in public equities. By the third quarter of 2012, that allocation target for public equity had dropped by 21 percentage points, or to 42 percent of total funds. While allocations were taken away from public equity investments, SRPS increased its allocation target for alternative investments (real estate, real return, private equity, and absolute return) from just 9 percent of total funds in the first quarter of 2008 to over 40 percent of total funds in the third quarter of 2012.[47] [48]

[47] State Retirement and Pension System, "Quarterly Investment Update: Asset Class by Market Value and Allocation at 3/31/2008," *Reports and Updates* (2008, Quarter 1), Maryland State Retirement Agency.

SRPS's plans to move allocation targets away from public equities and into the private markets is concerning to the interviewees, as they have observed little to no growth in the universe of minority- and woman-owned firms investing in private markets. General opinions are that the move toward private markets shows a lack of sensitivity toward minority fund managers, particularly those minority- and woman-owned firms attempting to gain SRPS as a client. The growing allocation target for private markets within Terra Maria and the greater portfolio will greatly impact future inclusion of minority- and woman-owned firms within SRPS's portfolio.

3.6 Graduation Requirements

A selection of State-run emerging manager programs has set up formal processes to graduate emerging investment managers. Requirements for graduation vary from system to system and often depend on the performance and tenure of the manager. In Maryland, emerging managers may be allowed to manage a larger amount of assets when they consistently reach or exceed performance benchmarks, but there is no defined standard or formal process for graduation from Terra Maria.

For comparison, the retirement system in Allegheny County, Pennsylvania will give an emerging manager two additional asset allocations if the manager's performance consistently meets or exceeds benchmarks for its asset class. After a minimum of three years, Allegheny will graduate an emerging manager based on its stability, growth, and performance. In Allegheny, graduating means inclusion into the main investment program for the retirement system.[49]

In Chicago's Teachers' Pension Fund, graduation is based on whether or not the fund has the capacity for the emerging manager's investment strategy. If so, the emerging manager graduates and moves from the emerging manager program to a direct relationship with the system. Once graduated, managers cannot be used by managers-of-managers for the same product or service.[50]

While Maryland does not employ a formal graduation program, SRPS may increase allocations to managers in the Terra Maria program if they grow beyond the emerging manager standards (having assets under management between $10 million and $2 billion). Similar to Chicago's informal process, Maryland may move an emerging manager into a direct investing relationship with the System based on performance and strategy fit with the overall portfolio of the System. The informal graduation process is also due in part to the Investment Division's decision not to place a formal size standard on emerging managers. This allows the System to retain a well-performing emerging manager if the fund does not have the capacity to increase assets under management.

Interviewees outside SRPS and its Terra Maria program expressed concern regarding SRPS's informal graduation process for emerging managers and whether or not the informal process

[48] State Retirement and Pension System, "Quarterly Investment Update: Asset Class by Market Value and Allocation, September 30, 2012," *Reports and Updates* (2012, Quarter 3), Maryland State Retirement Agency.
[49] Retirement System of Allegheny County, *Emerging, Minority and Women Owned Investment Manager Program*, Allegheny County, Pennsylvania, 16 September 2010,
[50] Chicago Teacher's Pension Fund, "Diversity Policy of the Chicago Teachers' Pension Fund," Chicago, Illinois (2010), Accessed September 24, 2012.

benefits minority firms. SRPS noted that the informal process is a positive factor because it allows for emerging managers to remain in the program until the System's larger portfolio has the capacity for that manager's investment strategy. That benefit is also supported by the lack of a size standard for emerging firms. The informal process has also been viewed, based on interviews, as a concern for minority and emerging managers because it allows SRPS staff to be subjective in its decision to graduate or terminate emerging managers due to a lack of formal policy. A few interviewees felt that this issue was a general emerging manager issue rather than a minority or gender issue.

4.0 Conclusions and Recommendations

4.1 Conclusions

SRPS's continual expansion of the Terra Maria Program has led to tremendous gains in the inclusion of minority investment managers since the passing of SB 606. The Terra Maria program has facilitated growth not only for SRPS but also for the emerging managers, as several have moved to emerged status allowing for increases in assets for minority managers including Brown Capital Management, Earnest Partners, and Rock Creek Potomac Fund.

Additionally, SRPS's exclusion of size standards for its emerging managers has allowed the System to retain minority managers when they would have otherwise needed to be terminated from the program, if that manager's strategy was not used by the larger portfolio. Fortunately, a majority of the emerged managers use strategies involving private equity, fixed income, credit strategies, and alternative investments. SRPS's current strategy is to move away from public equity and toward fixed income and alternative investments.

Other states' and cities' emerging manager programs, particularly those in Illinois and Chicago, have set specific policy on asset allocation targets for minority fund managers and brokers based on asset class, whereas Maryland's SRPS has no specific policy for broker utilization concerning use of step-outs and minority brokers. The lack of policy on broker utilization is, in large part, likely due to the fact that minority managers select brokers with their own discretion. SRPS always considers its fiduciary duties above all else, which may also explain why minority brokers are not necessarily recommended over majority brokers.

SRPS provided detailed accounts of its vetting, hiring, and firing processes for the most recent fiscal year. Their accounts were verified by the responses of the program managers who, when asked about the capacity of SRPS staff to perform due diligence, described the various meetings, phone calls, and reports and monitoring involved in their eventual attainment of funds from the pension. Program managers also verified that the treatment toward and growth of investment managers, once hired by SRPS, has been fair and that the performance requirements of each minority manager are not different compared to majority firms.

4.2 Recommendations

Based on interviews, research, and analysis, the following are RESI's recommendations for SRPS's asset management practices.

1. **Reduce barriers to entry for minority- and women-owned investment managers seeking assets from SRPS by expanding outreach efforts.**

The capacity of SRPS to perform effective outreach methods and best practices appears to be the main barrier to entry for minority- and woman-owned investment managers seeking assets from SRPS. The barrier could be reduced if SRPS considered the following measures:

- Greater attendance and advocacy for groups (such as the Robert Toigo Foundation) or associations holding conferences or forums for the broad purpose of creating opportunities for minority investment managers;
- Hosting of conferences, forums, or meetings with minority investment managers and brokers to discuss specific opportunities with Maryland's pension system;
- Building a database of minority- and woman-owned private equity management firms; and
- Developing other ways to improve its inclusionary efforts of investment managers in the private markets.

SRPS is changing its asset allocation strategy to be less dependent on investments in public equities. Program managers emphasized that most fund managers understand that allocation targets often change as a trend of the entire industry to reduce risk, generate more alpha, or meet performance benchmarks. However, whether changes in SRPS's asset allocation targets will lead to termination or a reduction of assets to minority managers in the public market remains a vital concern for all parties involved as interviewees confirmed that the universe of available and qualifying minority investment managers outside public equities is relatively small. As such, Interviewees recommended improving SRPS's inclusionary efforts of investment managers in the private markets.

2. **Increase the accessibility of SRPS staff to minority- and women-owned investment managers seeking opportunities within the System.**

Internally, SRPS and its program managers feel that minority and emerging managers have been treated fairly and professionally while maintaining and upholding the fiduciary duties outlined in Maryland's investment policy. Externally, interviewees felt that communication with SRPS was easier for managers with existing contacts either with internal or external SRPS staff. For experienced minority- and woman-owned managers who are not considered emerging, the barrier of communication needs to be broken down, as those managers are not likely to go through a manager-of-managers to gain clients.

Another observation and recommendation by the interviewees from outside SRPS was that the hands-on approach of the Investment Division leads to the addition of extra responsibility to the existing staff. Entrusting more responsibility or vetting of managers to its consultants and program managers may increase the overall staff's capacity to identify and select minority managers, especially in the private markets where minority inclusion is particularly lacking.

3. **Clarify for managers the vetting process and requirements for receiving funds from SRPS.**

While SRPS has greatly improved its inclusion of minority managers since the passing of SB 606, the communication barrier is compounded by the vigorous and complex vetting process.

Some firms who are finding it impossible to communicate with SRPS staff are unable to receive clarification of what requirements must be met in order to receive a recommendation for funds. As stated in the interviews with SRPS's external fund managers, the vetting process can take up to one or more years before a hiring decision is made, and managers have to deal with both internal staff and either program managers or investment consultants of SRPS throughout the entire process.

4. **Continue to allow joint ventures and limited partnerships to receive funds from SRPS as a method of increasing SRPS's utilization of minority fund managers.**

To support utilization of minority private equity firms, SRPS is allowing joint ventures and limited partnerships between minority and majority firms. As shown in Figure 3 of Section 3.4, there are currently four joint ventures for credit strategies between Advent Legacy Partners and Wellington Asset Management; Blaylock Robert Van and Marathon Asset Management; Castle Oak Securities, Park Madison Partners and Angelo Gordon; and RLJ and Western Asset Management. SRPS's allowance of joint ventures has created an opportunity for minority firms to invest in credit strategies for the participants while lowering the System's risk and cost of using smaller or emerging firms.

5. **Create clear, standardized benchmarks and graduation standards for emerging firms.**

All program managers pointed out that the use of a customized, weighted benchmark for the Terra Maria program was different but not necessarily unfair compared to their other public pension clients, who tend to use a standard industry benchmark. The use of the weighted benchmark may be one of the guidelines or requirements that other interviewees felt was either confusing or unclear to minority investment managers trying to approach SRPS for investment opportunities.

Interviewees of various disciplines almost unanimously expressed the desire for a clear and written graduation process for the Terra Maria program, as the goal for all emerging management firms is to eventually receive greater allocations of funds, and eventually to gain a direct relationship managing funds for the plan sponsor (SRPS). Alternatively, SRPS and a few other interviewees feel that the lack of graduation program is a positive as graduation programs in other states have led to termination of managers whose strategies were not needed in the larger portfolio, but they no longer qualified as emerging managers (having less than $2 billion in assets under management).

It is important to note that a majority of the original emerging minority managers in the Terra Maria program whose strategies involved credit, fixed income, or alternative investments have become emerged managers and have been allocated larger amounts of funds. Typically, the emerged managers investing in private markets are handling more capital-intensive mandates. The definition of an emerging manager is a qualifying firm with at least $10 million but less than $2 billion in assets under management. An emerged investment manager is a qualifying firm with more than $2 billion in assets under management. SRPS should consider adopting this or a similar standard for graduating emerging managers.

6. **Consider developing an "evergreen" program for allocating funds within the Terra Maria program.**

One of the program managers interviewed for this report recommended the potential use of an "evergreen" program that would entail allocating money in the Terra Maria program for the specific purpose of hiring new minority fund managers. Currently, as shown in Section 3.5, SRPS has historically set allocation targets so that 100 percent of its funds are being invested each quarter.

An evergreen program is a potentially viable solution to SRPS's lack of a graduation program as well as the recent slowdown in inclusion of minority- and woman-owned firms (please refer to Figure 1). Evergreen programs involve setting aside funds for allocation to existing emerging managers who have exceeded their given benchmarks, or for allocation to new emerging managers.

7. **Consider hiring an additional program manager to help manage the growing number of emerging managers used by SRPS.**

The data from GOMA's annual reports show that each program manager has at least ten fund managers under its purview. If SRPS is planning to expand the program to include more managers from different asset classes, it may be prudent to eventually hire an additional program manager.

5.0 References

"A New Generation of MWBEs for New York State: A Summary and Analysis of Recent New York State Legislation for Minority and Women Business Enterprises." Bryan, Burgher, Jaffe and Roberts, LLP. (October 2010). Accessed via web. http://www.bbjrlaw.com/2C0296/assets/files/News/A%20Summary%20and%20Analysis%20of%20Recent%20New%20York%20State%20Legislation%20For%20Minority%20and%20Women%20Business%20Enterprises.pdf.

Atwood, William R. "Report on Emerging Money Managers (Public Act 96-0006)." Illinois State Board of Investment. 19 December 2011. Accessed via web. 25 July 2012. http://www2.illinois.gov/isbi/Documents/Emerging-and-Minority-Manager-Report.pdf.

Chicago Teacher's Pension Fund. "Diversity Policy of the Chicago Teachers' Pension Fund." Chicago, Illinois (2010). Accessed September 24, 2012 from http://ctpf.org/general_info/Investments.htm.

Cypress, Zanes. *Report on the Usage of Minority and Women-Owned Brokerage and Investment Management Firms by the State of Maryland.* Governor's Office of Minority Affairs. Fiscal Year 2009.

Employees Retirement System of Texas. *ERS Emerging Manager Program Report to the 82nd Texas Legislature*. Texas (May 2011). Accessed via web. 27 July 2012. www.ers.state.tx.us/Reports/Emerging_Manager_Report.

"Investment Policy Manual." *State Retirement and Pension System of Maryland State Retirement Agency*. August 2006. Accessed October 2012. http://www.msa.md.gov/megafile/msa/speccol/sc5300/sc5339/000113/003000/003548/unrestricted/20070383e.pdf.

Jon Wainwright, et. al. "The State of Minority- and Woman-Owned Business Enterprise: Evidence from New York." NERA Economic Consulting (April 29, 2010).

Maryland General Assembly. Department of Legislative Services. 2008 Session. *SB 606, State Government – Brokerage and Investment Management Services – Use of Minority Business Enterprises* [introduced to Maryland General Assembly; 29 February 2008]. 2008 Session codified under chapter 600. Fiscal Policy Note.

Maryland General Assembly, Department of Legislative Services. 2012 Session. *SB 779, State Retirement and Pension System – Study of Asset Management* [effective 1 July 2012]. 2012 Session. Fiscal Policy Note.

Maryland Governor's Office of Minority Affairs. *Report on the Usage of Minority and Women-Owned Brokerage and Investment Management Firms by the State of Maryland for Fiscal Year 2010.* Accessed 24 July 2012. http://www.mdminoritybusiness.org/documents/2010GOMA2010InvestmentReportFINAL.pdf

Maryland State Retirement and Pension System Board of Trustees. *Minority Owned Financial Services Firm Usage: Annual Report Questionnaire Fiscal Year 2011*. Submitted to Governor's Office of Minority Affairs. 31 August 2011. http://dlslibrary.state.md.us/publications/Exec/SRA/SPP21-116(d)(4)_2011.pdf.

"MBE/DBE/ACDBE eligibility standards can be broken down into five key standards". *MDOT's Office of Minority Business Enterprise (OMBE) Overview*. http://www.mdot.maryland.gov/Office%20of%20Minority%20Business%20Enterprise/Overview

Municipal Employees' Annuity and Benefit Fund of Chicago. "Investment Policy Document." Chicago, Illinois (June 2012). Accessed September 24, 2012 from http://meabf.org/publications/Appendix_F___BROKERAGE_POLICY_20120630.pdf.

New York State Teachers Retirement System. *Minority and Women-Owned Business Enterprises (MWBE) Asset Management and Financial Institution Strategy Report for the 2010-11 Fiscal Year.* New York. 1 September 2011. Accessed via Web. 25 July 2012. http://www.nystrs.org/main/library/MWBE_Report_2011.pdf.

Retirement System of Allegheny County. *Emerging, Minority and Women Owned Investment Manager Program.* Allegheny County, Pennsylvania. 16 September 2010. http://www.county.allegheny.pa.us/retirement/EmergingMgr.pdf.

State Employees' Retirement System of Illinois. *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011.* Illinois (2011).

State Retirement and Pension System. *Comprehensive Annual Financial Report 2008.* Maryland State Retirement Agency. June 30, 2008.

State Retirement and Pension System. *Comprehensive Annual Financial Report 2011.* Maryland State Retirement Agency. June 30, 2011.

State Retirement and Pension System. *Investment Policy Manual for the Board of Trustees of the Maryland State Retirement and Pension System.* Maryland State Retirement Agency. August 2011.

State Retirement and Pension System. "Quarterly Investment Update: Asset Class by Market Value and Allocation at 3/31/2008." *Reports and Updates* (2008, Quarter 1). Maryland State Retirement Agency.

State Retirement and Pension System. "Quarterly Investment Update: Asset Class by Market Value and Allocation, September 30, 2012." *Reports and Updates* (2012, Quarter 3). Maryland State Retirement Agency.

State Retirement and Pension System. *Terra Maria: Developing Manager Program in Public Markets and Private Equity* (February 2011). Maryland State Retirement Agency. Accessed 26 July 2012. http://www.sra.state.md.us/Agency/Investment/Downloads/TerraMariaDevelopingManagerProgram-Description.pdf

U.S. Census Bureau. "ACS Demographic and Housing Estimates, 2011 American Community Survey 1-Year Estimates (Illinois and Maryland)." *American Factfinder 2*. Accessed October 17, 2012. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_11_1YR_DP05&prodType=table.

U.S. Census Bureau. "Table 5. Summary Statistics for Minority-Owned Firms by State and Kind of Business: 2007." *2007 Survey of Business Owners* (Released June, 7 2011). Accessed November 26, 2012 from http://www2.census.gov/econ/sbo/07/final/tables/cosum_table5.pdf.

"Utilization Data Comparison 2008 thru 2011." Government Office of Minority Affairs. *E-mail.* Accessed 31 July 2012.

Appendix A—Interview Questions[51]

A.1 State Retirement and Pension System Staff

1) How are minority and women-owned fund managers and brokers chosen?
   a) If internal sources/personnel are used to seek out and vet minority fund managers and brokers, what factors are used to determine the capacity of this individual to perform?
   b) If external resources, such as consultants, are used, please explain why.
   c) What selection criteria and process was used in selecting the consultant?

2) Have there been minority- or women-owned firms chosen through this process (whether private equity, public equity, or real estate) that did not meet the standards set forth by SRPS?
   a) What steps were taken to reach out to and discuss the problem with the minority- or women-owned firms?
   b) Was any action taken to discuss this matter with the source used to identify these firms?

3) Are consultants or program managers rotating positions?
   a) If so, how often to these positions rotate?
   b) What is the selection process for determining the capacity of the consultant or program manager?
   c) How does SRPS decide to hire these firms?

4) What is the process for selecting a new minority fund managers and brokers?

5) Do you meet them face-to-face prior to confirming selection?

6) Do recommendations by external sources typically end in negotiations with the fund manager or broker?
   a) If so, how many have been minority- or women-owned?
      i) What is the percentage of current minority- and women-owned fund managers that have been retained through this method?
   b) If no, what do you believe is the percentage of current minority fund managers used by the state retirement and pension system fund that have been retained as a result of this internal recommendation?

7) How many of the current minority fund managers do you believe are obtained through processes outside of internal recommendations?

8) Have you worked with other state retirement pension funds in the past?
   a) If yes, how does Maryland's differ from those funds in the selection of minority fund managers?

9) What are some of the expectations set by SRPS of their fund managers and brokers?

[51] Using these base questions, certain interviews were tailored based on the person or firm spoken to.

10) How are these expectations set by SRPS of their fund managers and brokers?

11) Have there been firms that were recommended to SRPS by program managers and/or consultants that were not accepted in the past?
    a) Please identify the factor(s) that contributed to this decision.
    b) Is it possible to obtain a list of those firms that have been rejected?

12) Do you believe there is a better system for securing new minority fund managers for the state retirement and pension system? If yes, what are some of your recommendations?

A.2 SRPS Follow-up

1) In our recent interview, SRPS highlighted that internal staff assist in identifying private equity firms. After reviewing various meeting minutes and news articles, we have identified a group called "Altius," which appears to be deeply involved in this process. Can you please elaborate on this consultant's role as it deals with the identification of private equity minority fund managers?

2) Outside the Terra Maria program, what is the process used to identify and choose potential minority- and women-owned fund managers and brokers?
    a. If the process includes SRPS staff members…
        i. What are some of the key responsibilities of these staff members?
        ii. What key background characteristics are used in determining the success of staff member recommendations?
    b. If the process includes outside vendors…
        i. How does SRPS review the suggestions?
        ii. What are some of the outside vendors' key characteristics that may help to provide credence to the capacity and success of the firm recommended?

3) Have there been minority- or women-owned firms chosen through this process (whether private equity, public equity, or real estate) that did not meet the standards set forth by SRPS?
    a. What steps were taken to reach out to and discuss the problem with the minority- or women-owned firms?
    b. Was any action taken to discuss this matter with the source used to identify these firms?

4) Are consultants or program managers rotating positions?
    a. If so, how often to these positions rotate?
    b. What is the selection process for determining the capacity of the consultant or program manager?
    c. How does SRPS decide to hire these firms?

5) Do recommendations by external sources typically end in negotiations with the fund manager or broker?
    a. If so, how many have been minority- or women-owned?
    b. What is the percentage of current minority- and women-owned fund managers that have been retained through this method?

6) What are some of the expectations set by SRPS of their fund managers and brokers?

7) How are these expectations set by SRPS of their fund managers and brokers?

8) Have there been firms that were recommended to SRPS by program managers and/or consultants that were not accepted in the past?
    a. Please identify the factor(s) that contributed to this decision.
    b. Is it possible to obtain a list of those firms that have been rejected?

9) You noted that SRPS attempts to communicate with any potential firms and offers open communications with those currently being used. Is it possible to obtain a list of those firms that SRPS has met with in the last year?

A.3 Terra Maria Program Managers

1) Is your organization's office headquartered in Maryland, or does your organization have an office located within the state?

2) How long has your organization been in operation?

3) How did your organization learn about the opportunity to work with the SRPS?

4) Was your firm successful in gaining SRPS as a client?

5) Do you believe that the individuals vetting your firm's qualifications had the requisite experience to determine your capabilities?

6) Do you believe that the commission percentage for your firm is comparable to non-minority firms?

7) What is your organization's experience with managing state retirement pension funds?

8) If your organization has past experience, how was your organization and the client introduced?

9) Did your organization complete the online questionnaire provided by SRPS?
    a) If yes, how long before your organization heard a response?
    b) If no, did your organization have any trouble locating the questionnaire?

10) Did your organization meet with personnel with the authority to hire your firm?

a) If yes, do you believe that your organization was evaluated or treated less favorably due to race, ethnicity, and/or gender?
b) To the extent that you feel comfortable, please provide details regarding any business dealings with SRPS in which you were treated less favorably due to race, ethnicity, and/or gender.

11) If your organization was involved with SRPS last year, what was your organization's excess return in relation to the benchmark?

12) In your organization's meetings with SRPS, did your organization discuss meeting a percentage of the benchmark or an alpha that you believed to be different from the industry standard?

13) Do you believe that there are barriers to the participation of minority- and women-owned firms in the management of SRPS funds in all asset classes?
a) If so, please provide details and give recommendations for overcoming those barriers.

A.4 Terra Maria Emerging Managers

1) How long has your organization been in operation?

2) How did your organization learn about the opportunity to work with your current program manager in the Terra Maria program?

3) What year did you officially become involved with the Terra Maria program?

4) Do you have any prior experience with other State Pension funds?

5) If your organization has past experience, how were your organization and the client introduced?

6) Did your organization complete any forms or submit a RFP to your current program manager under Terra Maria?

7) Since your involvement with Terra Maria, has your group received any new allocation of funds?

8) Comparing your experience, do you believe there are any recommendations that can be made to strengthen the program?
a) If so, please give an example.

Appendix B—Summary of Contacts and Responses

B.1 State Retirement and Pension System Contacts and Responses

Figure 13 includes date, firm/organization, interviewee(s), and their job title(s) for all interviews RESI has conducted.

Figure 13: Contacts by Date of Interview, Firm, and Title—SRPS

Interview Date	Firm	Contact	Title	Notes Confirmed[52]
8/22/2012	State Retirement and Pension System	Dean Kenderdine and Dr. A. Melissa Moye	Executive Director and CIO	Yes
10/5/2012	State Retirement and Pension System; Attorney General	Dean Kenderdine and Debbie Bacharach	Executive Director and Principal Counsel	Yes

Source: RESI

Figure 14 includes a summary of responses to selected questions asked to SRPS staff about operational framework, fiduciary duties, and other information as it relates to SRPS's capacity to search for, reach out to, and select minority- and woman-owned investment management and brokerage firms.

Figure 14: Summary of Responses—SRPS

Questions	Answers
How are minority and women-owned fund managers and brokers chosen? a) If internal sources/personnel are used to seek out and vet minority fund managers and brokers, what factors are used to determine the capacity of this individual to perform? b) If external resources, such as consultants, are used, please explain why. c) What selection criteria and process was used in selecting the consultant?	The program manager structure of the Terra Maria program provides avenues (questionnaires, meetings, presentations or conferences, and white papers) for identifying potential smaller managers, including minority firms. Agency staff and external consultants also play a role in identifying firms and performing due diligence. Selection criteria are race- and gender-neutral per statute and advice of chief counsel. The overarching goal is to hire high performing managers who will provide the trust fund with excess returns over time. In the Terra Maria program, active managers

[52] RESI provides notes to all interviewees for the purpose of ensuring accuracy of the meaning and language used during the interview and to provide a chance for interviewees to provide any supplemental responses not provided at the time of the interview. Interviewees who have not yet confirmed accuracy of notes are marked "No" under this column.

Questions	Answers
	have generally had up to $10 billion AUM, compared to a $2 billion AUM cap in other emerging manager programs.
Outside of the Terra Maria program, how are minority- and woman-owned fund managers and brokers identified and selected?	Investment managers are selected to meet performance standards and portfolio diversification. Once selected, managers are expected to outperform net of fees. All managers must pass a legal and commercial due diligence review before finalizing a contract. The two key staff for this role are the managing director and the senior analyst who work with other staff to pull together and use resources for the purpose of identifying high-performing managers in a race- and gender-neutral method.
Please elaborate on the role of consultant Altius Associates as it deals with the identification of private equity minority fund managers.	Altius Associates is referred to when SRPS needs assistance with due diligence, and manager monitoring and identification. Altius Associates can recommend managers, but SRPS staff must also recommend those managers to the CIO. Since 2010, Altius and SRPS have attended a number of industry events and collected resources for the purpose of developing and maintaining a diverse database of private equity managers.
Have there been minority- or women-owned firms chosen through this process (whether private equity, public equity, or real estate) that did not meet the standards set forth by SRPS? a) What steps were taken to reach out to and discuss the problem with the minority- or women-owned firms? b) Was any action taken to discuss this matter with the source used to identify these firms?	There have been cases where at some point subsequent to hiring, concern has risen regarding the demonstrated performance, compliance and/or capacity of an investment manager. The Investment Policy Manual states a manager may be terminated "for any reason at any time." If there is persistent underperformance, investment staff requests an explanation. Staff also conducts quarterly, monthly, and semi-annual reviews of all managers (this includes face-to-face discussions). Managers are required to report any significant changes in ownership or personnel, litigation, substantial reduction in AUM, changes in strategy or style, and underperformance.
What is the process for selecting new minority	Hiring is done using a publicized, competitive

Questions	Answers
fund managers and brokers?	process to evaluate both the product and fees. Due to an act of legislature in 2007, the CIO ultimately decides who to hire, terminate, or increase/decrease allocations.
Do recommendations by external sources typically end in negotiations with the fund manager or broker?	In 2012, external consultants and program managers recommended four managers that were eventually approved. Not all managers are approved after receiving recommendation from a consultant or program manager. Approximately 67 percent of managers hired through this method were retained through FY 2012.
Are consultants or program managers rotating positions? If so, how often do they rotate?	For consultants, typically the initial contract term is not more than five years. Program managers and Investment managers do not have term limits, but can be fired at any time. Since the current CIO has been in place, no consultant or program manager has been fired. All managers and consultants agree to act as fiduciaries of the system.
What are some of the expectations set by SRPS of their fund managers and brokers?	Terms of the relationship with SRPS are outlined in either a contract (for public markets) or a partnership agreement and side letters (for private funds). Terms include investment guidelines for each mandate/fund, benchmarks, limitations such as investing outside of the benchmark, outside of a region, etc. For private funds, the agreement would include a notice required for withdrawal from commingled funds, and the requirements for investors to fund commitments.
How are the expectations set by SRPS to fund managers?	Through the process of contracting, this normally includes multiple communications among the parties and their legal counsel.
Have there been firms that were recommended to SRPS but not accepted in the past?	Specific factors contributing to rejection are: • The strategy or type of investment is already fully represented elsewhere in the portfolio, • The risk/reward profile is not appropriate for the portfolio, • The manager does not excel in the strategy that SRPS needs for the portfolio,

Questions	Answers
	• The manager does not have adequate capacity in the regions its strategy covers, • The managers fees are too high, and/or • SRPS is unable to successfully negotiate terms with the manager/fund.
Do you believe there is a better system for securing new minority fund managers for the state retirement and pension system? If yes, what are some of your recommendations?	SRPS does not typically provide seed capital for private funds, so firms must have significant prior experience (not necessarily based on size). Private fund investment requires a commitment of SRPS funds, typically for a minimum of 10 years. The vetting process is intense and often involves following a firm over a number of years, through the investment and at least partial realization of its pre-fund, Fund I and sometimes even Funds II, III and IV investments, before resulting in a positive recommendation. SRPS attempts to solve the above complications by allowing joint ventures with minority and majority firms (as shown in GOMA's reports).

Sources: RESI, SRPS

The following list summarizes RESI's discussion with SRPS's Executive Director, Dean Kenderdine, and SRPS's Principal Counsel, Debbie Bacharach, from the Maryland Attorney General's Office.

Terra Maria Program

- Outreach is focused toward increasing the ability for minority and emerging managers to have access to SRPS for asset management opportunities in its investment program.
- Terra Maria is NOT a certified MBE program, as most would not qualify based on size standards.
- The agency works to adhere to a 25 percent MBE goal outside of investment (via procurement contracts) and has usually met the goal.
- Enactment of state legislation preceded the establishment of the Terra Maria program. The law required certain agencies including SRA, to identify and address barriers to minority asset management firms' participation in those agencies' investment programs.

- The SRPS Board and the CIO for the SRPS, at the time of the legislation, identified one of the biggest barriers to access as being insufficient staffing at SRA needed to source and assist in monitoring emerging managers.

Important Legislation, Statutes, Etc.

- Debbie Bacharach stresses that the retirement fund is a trust fund, not state money, but funds that are held solely for the benefit of the participants of the SRPS that is derived from the contributions of the participants, the contributions from participating employers, and the income generated by the SRPS investment of those contributions. Legislation that affects the management of those funds can present challenges to the fiduciary responsibilities of the SRPS Board of Trustees and certain agency staff who are also fiduciaries (executive director, CIO).
- Debbie Bacharach provided print outs of statutes and other materials emphasizing the fund's fiduciary responsibilities as outlined in Maryland code, she also provided a copy of a bill review letter from the Attorney General regarding the implementation of SB 606. (The provided materials were used in RESI's explanation of SRPS's operation framework and fiduciary duties in this report).
- Ms. Bacharach explained the **Exclusive Benefit Rule:** Fiduciaries have to act solely in the interest of the participants for the exclusive purpose of (1) providing benefits to participants and (2) paying reasonable expenses of operating the pension system.
- The rules and statutes apply to staff, board, and contractors/consultants of SRPS. Contractors/consultants that act in their own interest can reasonably be terminated and sued.
- Ms. Bacharach provided the example of laws enacted by the General Assembly that requires the SRPS to divest its assets from companies doing business in Iran and Sudan. In those cases, the SRPS conducted thorough analyses of all relevant investments and did divest from certain companies but only where other comparable substitute investments were available.

How SRPS Works with Legislators When New Mandates Are Passed

- During each legislative session, SRPS holds a weekly review of bills going through House and Senate. Prior to and during the 2012 session, Senator Pugh did meet with SRA to discuss possible legislation that would address minority firm participation in the SRPS alternative investment portion of the SRPS program.
- There have been occasions when certain interests, including some state legislators have encouraged SRPS investments in Maryland businesses, known as "economically targeted investment."

Selection of Brokers

- SRPS cannot do an "emerging broker" program because all SRPS assets are managed externally. The asset managers under contract to SRPS hire brokers to execute trades and are held to a "best execution" standard. SRPS advises minority brokers as to who the SRPS asset managers are, and has provided its asset managers with the contact information for minority brokers that it is made aware of.

B.2 Terra Maria Program Managers Contacts and Responses

Figure 15 includes date, firm/organization, interviewee(s), and their job title(s) for all interviews RESI has conducted.

Figure 15: Contacts by Date of Interview, Firm, and Title—Program Managers

Interview Date	Firm	Contact	Title	Notes Confirmed[53]
9/17/2012	Bivium Capital	Lawrence Bancroft and Margaret Jadallah	President and CEO, and Managing Director	Yes
9/20/2012	FIS Group	Tina Williams and Cesar Gonzales	CIO and CEO, and Senior VP of Investment Programs	Yes
9/27/2012	Leading Edge Investment Advisors	Clayton Jue	President and CEO	Yes

Source: RESI

Figure 16 includes a summary of responses to all questions asked to Terra Maria Program Managers.

Figure 16: Summary of Responses—Program Managers

Questions	Answers
Is your organization's office headquartered in Maryland, or does your organization have an office located within the state?	None of the program managers interviewed are located in Maryland. Bivium Capital and Leading Edge Investment Advisors are located in California. FIS Group is located in Pennsylvania.
How long has your organization been in operation?	Of the program managers interviewed, years in operation ranged from 7 to 16+ years of experience as fund-of-fund managers.
How did your organization learn about the opportunity to work with SRPS?	All three program managers stated that an RFP and an intent to expand the emerging manager program in Maryland was released in a trade publication. Leading Edge Investment Advisors noted that they had also been contacted directly about the RFP because their

[53] RESI provides notes to all interviewees for the purpose of ensuring accuracy of the meaning and language used during the interview and to provide a chance for interviewees to provide any supplemental responses not provided at the time of the interview. Interviewees who have not yet confirmed accuracy of notes are marked "No" under this column.

Questions	Answers
	Business Development Director had called Maryland prior to the RFP in order to build a direct relationship with SRPS.
Was your firm successful in gaining SRPS as a client?	All three firms were successful in gaining SRPS as a client through the second RFP to expand the emerging manager program. Bivium noted that it had also replied to the initial RFP that was only awarded to Northern Trust Global Advisors.
Do you believe that the individuals vetting your firm's qualifications had the requisite experience to determine your capabilities?	All three of the program managers interviewed answered "yes." Program managers mentioned various meetings with SRPS staff on numerous occasions to perform due diligence. SRPS staff, including Mansco Perry (former Chief Investment Officer for SRPS), visited out-of-state managers as part of due diligence.
Do you believe that the commission percentage for your firm is comparable to non-minority firms?	The program managers were generally unsure of how SRPS determines allocation of funds, but noted that allocation does not seem to be based on performance as program managers who exceeded their benchmarks were not allocated additional funds or given comparable amounts.
What is your organization's experience with managing state retirement pension funds?	All program managers interviewed stated having between 5 and 10 state pensions as clients, including Maryland's. For the younger firm, Leading Edge Investment Advisors, experiences came from over 20 years working for other firms.
If your organization has past experience, how was your organization and the client introduced?	All three program managers responded to RFPs to be selected by their clients. They also stated that building direct relationships and having direct communication with potential clients has been key to gaining funds. Bivium Capital noted that the overall process of selection with Maryland took at least 2 years (including initial communication prior to the second RFP), which is on par with its experience with other clients.

Questions	Answers
Did your organization complete the online questionnaire provided by SRPS? c) If yes, how long before your organization heard a response? d) If no, did your organization have any trouble locating the questionnaire?	Both Bivium Capital and FIS group said that between filling out the questionnaire and RFP for SRPS, it took about 6 to 7 months to receive funds, which is fairly quick.
Did your organization meet with personnel with the authority to hire your firm? a) If yes, do you believe that your organization was evaluated or treated less favorably due to race, ethnicity, and/or gender? b) To the extent that you feel comfortable, please provide details regarding any business dealings with SRPS in which you were treated less favorably due to race, ethnicity, and/or gender.	All three program managers feel that treatment by SRPS has been fair in general and in comparison to other experiences in the industry. FIS Group noted that despite changes in the CIO position, the Investment Division staff has not changed, allowing for a smooth transition between CIOs.
If your organization was involved with SRPS last year, what was your organization's excess return in relation to the benchmark?	The program managers are given a customized benchmark that is a weighted average of a few market benchmarks. All respondents reported exceeding the customized benchmark in previous years.
In your organization's meetings with SRPS, did your organization discuss meeting a percentage of the benchmark or an alpha that you believed to be different from the industry standard?	Some clients use traditional market benchmarks, some use a customized benchmark similar to SRPS's but neither is better or worse – it depends on the client and their investment goals.
Do you believe that there are barriers to the participation of minority- and women-owned firms in the management of SRPS funds in all asset classes? a) If so, please provide details and give recommendations for overcoming those barriers.	(Please refer to Figure 18.)

Sources: Various program managers, RESI

Figure 17 lists the common perceived strengths and weaknesses of the Terra Maria program based on RESI's interviews with program managers.

Figure 17: Summary of Perceived Strengths and Weaknesses—Program Managers

Strengths	Weaknesses/Recommendations
FIS Group feels that in the public equities asset class, minority firms are treated fairly and are in a welcoming environment.	There is a unique rule for the Maryland pension fund that program managers cannot select a fund manager whose product is already used for the same asset class by another program manager within Terra Maria—program managers sometimes have to choose a less optimal fund manager due to this rule.
To Maryland's credit, it does not explicitly identify an upper limit for emerging managers' AUM, which allows them to retain those managers a little bit longer compared to programs that have an upper limit with no graduation process.	The lack of a graduation program - emerging managers may perform well and exceed benchmarks but if they have been working on funds in an asset class that is not needed in the broader portfolio, they can't be "promoted" and they may be terminated.
	Activity is increasing in the assets classes of hedge funds and private equity. SRPS's interest in moving funds to private markets is a cause for concern for minority fund managers. The universe of minority firms is already small, with most in public equities but still representing only 10 percent of the industry.
	Leading Edge recommended SRPS should attempt to schedule funds to be allocated each year for the distinct purpose of adding new emerging and minority- and woman-owned fund managers. This is something many states struggle with, and the program, if practiced, is referred to as an "evergreen" program. Talks of the program are increasing, but none of Mr. Jue's current clients practice it.

Sources: Various program managers, RESI

B.3 Terra Maria Emerging Managers Contacts and Responses

Figure 18 includes date, firm/organization, interviewee(s), and their job title(s) for all interviews with emerging managers that RESI has conducted.

Figure 18: Contacts by Date of Interview, Firm, and Title—Emerging Managers

Interview Date	Firm	Contact	Title	Notes Confirmed[54]
11/2/2012	Apex Capital Management	Jan Terbrueggen	Principal	No
11/5/2012	Phocas Financial Corp.	Kevin Granger	Portfolio Manager	Yes
11/5/2012	New Century Investment Management	Jeffrey Modell	Founder, President, and Portfolio Manager	Yes
11/7/2012	Advent Capital Management	Janina Kreider	Associate	Yes
11/7/2012	Hanoverian Capital Management	Sandra Yeager	Founder, President, and CIO	Yes
11/7/2012	Ambassador Capital Management	Brian Jeffries	President and CEO	Yes
11/9/2012	Opus Capital Management	Andy Bruns and Joe Condren	COO/CCO and Operations Coordinator	No
11/12/2012	Mar Vista Investment Partners	Silas Myers	Co-founder and Portfolio Manager	Yes
11/12/2012	ARGA Investment Management	A. Rama Krishna	CIO	No
11/13/2012	Lesa Sroufe & Co.	Lesa Sroufe and Kassie Vo	President and Director of Sales and Marketing	No
11/13/2012	Pugh Capital Management	Mary Pugh	CEO and CIO	Yes
11/15/2012	Stux Capital Management	Meredith Genova	Director of Marketing and Client Relations	Yes
11/15/2012	Westwood Global Investments	Ted Sullivan	Director of Marketing	No

Source: RESI

Figure 19 below provides a summary of the questions and answers from interviews with minority- and woman-owned investment management firms currently included in SRPS's Terra Maria program.

[54] RESI provides notes to all interviewees for the purpose of ensuring accuracy of the meaning and language used during the interview and to provide a chance for interviewees to provide any supplemental responses not provided at the time of the interview. Interviewees who have not yet confirmed accuracy of notes are marked "No" under this column.

Figure 19: Summary of Responses—Emerging Managers

Questions	Answers
How long has your organization been in operation?	An average of 12 years in operation, and a range of 3 to 25 years.
How did your organization learn about the opportunity to work with your current program manager in the Terra Maria program?	Several stated that existing relationships with fund-of-fund managers resulted in cash flows from the Terra Maria program.
What year did you officially become involved with the Terra Maria program?	5 of the 13 have been involved since 2008, 3 in 2009, another 5 in 2011,
Do you have any prior experience with other State Pension funds?	All respondents stated "yes" and most noted having multiple clients that are state pension funds.
If your organization has past experience, how were your organization and the client introduced?	Introductions were generally through a fund-of-fund manager, but some respondents have gained direct relationships managing funds for other states (either through graduation or from inception).
Did your organization complete any forms or submit a RFP to your current program manager under Terra Maria?	Requests for Proposals (RFPs) were often not filled out in order to receive allocations, as many minority managers had preexisting relationships with their program manager(s). Instead, annual and quarterly reports, questionnaires, and in-person meetings resulted in receipt of assets to manage for the Terra Maria program.

Questions	Answers
Since your involvement with Terra Maria, has your group received any new allocation of funds?	6 out of the 13 respondents confirmed receipt of additional allocations to manage for the Terra Maria program. The amount of additional cash flows ranged from $4 million to $45 million. (Based on performance data provided by SRPS—the asset class of each respondent who received additional funding were as follows: 1 credit, 3 fixed income, and 2 int'l equity.)
Comparing your experience, do you believe there are any recommendations that can be made to strengthen the program?	(Please refer to Figure 21.)

Sources: Various emerging managers, RESI

Figure 20 lists the perceived strengths and weaknesses of the Terra Maria program based on RESI's interviews with emerging minority- and woman-owned firms managing funds for SRPS.

Figure 20: Summary of Perceived Strengths and Weaknesses—Emerging Managers

Strengths	Weaknesses/Recommendations
Most common complaint to a client might be the choice of custodian, but Maryland uses State Street which is considered the best.	Recommended the survey delete the request for information on the venue used for execution as these days a single order is often filled through many venues to secure best execution.
A number of minority- and woman-owned fund managers stated that they had no recommendations, and that SRPS runs the Terra Maria program very well. Mr. Modell of New Century Investment Management described SRPS as a more "forward thinking fund."	CalPERS may have a graduation program, Illinois has a percentage goal of usage of minority and woman owned firms (17 percent), which is different from Maryland who has not specific goal for its program.
Part of the monitoring process is with SRPS investment staff. It seems like an incredible burden for a small staff, but Stux Capital was impressed by the willingness and ability of SRPS staff to engage with sub-advisors/fund managers.	Ambassador would recommend direct communication from the state to its fund managers about the overall objectives of the program, but more specifically clarification about graduation criteria.

Strengths	Weaknesses/Recommendations
As far as fair treatment and overall experience, managers felt that Maryland was doing a good job, but not necessarily in comparison to other states.	Advent would recommend that Maryland create a clearer understanding with fund managers on the expectations and requirements to graduate into the larger portfolio. In addition, having more direct dialogue to the System may increase the ability to graduate out of the program.
Mr. Krishna indicated that ARGA is projecting high returns on its current mandates in the future as they are currently at very attractive valuations (low and trending upward)-would hope that kind of performance leads to continued investment by ARGA for Maryland. Overall, fund managers seem to be performing well in comparison to benchmarks.	Improvement on communication is needed as far as the requirement of monthly performance updates. Mar Vista recommends creating an intermediate step between Terra Maria and having a direct relationship with the fund that allows for new AUM growth—perhaps periodically selecting several top performing firms to emerge through an intermediate process.
Opus Capital Management's experience has been similar to other clients, and overall Opus feels that the emerging manager programs have allowed them to grow over the last few years by more than 50%.	The visibility of the plan sponsor helps build relationships and provides a path in helping emerging managers to achieve success. SRPS is not always highly visible or accessible to managers in the Terra Maria program.
Phocas Financial stated that "other plans are not doing anything as far as due diligence that Maryland is not doing." Mr. Granger was particularly impressed with the vigor of one SRPS staff person's interview process when performing due diligence directly with sub-advisors. Mr. Granger characterized an SPRS staff person's recent interview as being very insightful and searching, in a way that a fund manager can't simply skate through. Additionally, no manager-of-manager was present, giving the sub-advisor a chance to express any grievances against a manager-of-manager; however, Phocas has none against Bivium.	Meredith Genova of Stux Capital mentioned a guideline that sets a limitation on the amount of any single stock that a manager can hold: "Not more than 5% or an amount equal to the security's weighting in the appropriate index, whichever is greater, of the total stock portfolio valued either at cost or at market may be invested in the common stock of any one corporation." While the guideline may be an effort to reduce risk for the portfolio, it can potentially create a barrier to generating higher alpha for stocks such like Apple that make up about 8 percent of the Russell 1000 Growth index. Managers end up holding the security at benchmark weight while they may be overweight in the same security for another client who does not have the same limitation.
Capital Prospects has been good with communication and running things smoothly. Overall, experience in the Terra Maria program has been good.	

Strengths	Weaknesses/Recommendations
Sandra Yeager of Hanoverian Capital stated that without programs like the Terra Maria program, she would not have started the firm. The programs allow smaller, minority- and woman-owned firms to get opportunities that would otherwise not be there.	

Sources: Various emerging managers, RESI

B.4 External Contacts

Figure 21 includes date, firm/organization, interviewee(s), and their job title(s) for all interviews RESI has conducted.

Figure 21: Contacts by Date of Interview, Firm, and Title—External Contacts

Interview Date	Firm	Contact	Title	Notes Confirmed[55]
8/22/2012	Meridian Management Group, Inc.	Stan Tucker	President and CEO	No
8/24/2012	State of Maryland	Catherine Pugh	Senator	No
9/17/2012		Zanes E. Cypress	Independent Investment Consultant	Yes
9/18/2012	National Association of Securities Professionals	Aileen Rappaport	Baltimore-Washington Chapter President	Yes
9/24/2012	Percival Financial Partners Ltd.	Ken Taylor	Founder and Broker	Yes

Source: RESI

Figure 22 lists the perceived strengths and weaknesses of the SRPS's utilization of minority- and woman-owned firms based on RESI's interviews with various external contacts (listed in Figure 21).

Figure 22: Summary of Perceived Strengths and Weaknesses—External Contacts

Strengths	Weaknesses/Recommendations
While goals are not specifically set by SRPS, it does allow for a higher AUM to still qualify as emerging or emerged and participate in the Terra Maria program. The average size of a	Look at other pensions who have percentage goals for minority firm utilization as opposed to the state of Maryland's pension fund which does not have a percentage goal.

[55] RESI provides notes to all interviewees for the purpose of ensuring accuracy of the meaning and language used during the interview and to provide a chance for interviewees to provide any supplemental responses not provided at the time of the interview. Interviewees who have not yet confirmed accuracy of notes are marked "No" under this column.

Strengths	Weaknesses/Recommendations
contract for an emerging manager is between $10 million and $100 million (fairly large compared to other programs).	
The requirements of the Terra Maria program are not clearly laid out by SRPS as they tend to change based on the fund-of-fund manager and the individual mandate. The broad goal of the program is to generate more alpha, which SRPS feels smaller firms can do.	There is a need for greater transparency on the policies used by SRPS to select smaller firms. Greater transparency will make SRPS appear more proactive toward using small and minority-owned firms.
The Terra Maria program is a positive for minority and female managers because they have greater representation amongst emerging managers. The emerging manager programs create a "two prong" system in which the emerging managers must adhere to the due diligence filters of the System, systematically gaining representation; and they must expand to conversation with institutional investors in order to gain direct investments.	Barriers exist for emerging and minority managers, but the consensus seems to be that the barriers are an industry-wide problem, and not specific to Maryland. There is the small firm issue, and the minority disparity issue. Because many minority and female firms are small firms, they deal with a mixed bag of barriers to entry within the industry. General obstacles are access to capital and access to larger investment mandates.
The due diligence process performed by SRPS's internal and external staff is very extensive. The pension's staff filters for the best in asset class and strategy – this includes the use of fund-of-fund managers as "program managers" or extensions of staff – Mr. Cypress who writes the annual reports for GOMA stated that this type of use of fund-of-fund managers is unique to Maryland.	SRPS may be nearing a commitment with one minority firm in the venture capital/private equity area, which it historically has not done. Better inclusionary efforts could be implemented/encouraged/expanded in private equity, real estate, and alternative investments.
Advocacy for the use of minority and woman-owned brokerage firms improved after the passing of SB 606.	There was some concern brought up about Altius Associates in the interview, they are perceived as unfriendly to minority firms in some of the industry groups/organizations, but an official expression of these concerns has not been made by any.
The SRPS has improved its use of minority and women managers greatly in the short time period between the passing of SB 606 in 2008 and in the most recent fiscal years. Went from a $326.5 million supporting seven minority and women managers in 2008 to a $4.1 billion with 61 minority and women managers in the program in 2011.Despite economy and general issues within the finance industry, SRPS has grown and has included	Some concerns about the qualifications of the new CIO were mentioned by interviewees, who felt that a CIO with less experience is now being given more responsibility for the entire portfolio. It can be both good and bad for minority managers that the CIO can bypass its "gatekeeper" Altius for manager selection, depending on her experience/capabilities. The new CIO has been described as not hostile but not open to dialog with new managers.

Strengths	Weaknesses/Recommendations
minority managers in its growth.	
There appears to be a correlation between legislation on minority firm inclusion and the availability of opportunities for minority fund managers in more aggressive states (California, Connecticut, Illinois, New York, and Texas).	SRPS had reported attending the 2011 NASP Baltimore-Washington Chapter conference, but the President of that chapter stated in an interview that they, in fact, did not attend due to scheduling conflicts. In addition, SRPS's recent appearance at the 2012 conference made it seem as if plans for the Terra Maria program were currently up in the air, causing concern amongst NASP members.
	Emerging managers often need to have connections to the fund-of-fund managers or external consultants in order to be aware of opportunities to gain funds from SRPS. This is a barrier to newer firms who do not have those connections, especially when direct communication with SRPS is difficult to achieve.
	Many NASP members and officials have been pushing for SRPS to create a graduation program for the Terra Maria program, stating that other successful plans like CalPERS and Illinois pension have such programs.

Sources: Various interviews, RESI