

# 840 CMR 16.00

## Investment Advice and Management

### Section

- 16.01 Definition
- 16.02 Employment of Qualified Investment Manager; When Permitted or Required; Delegation of Responsibility; Expenses; Contract
- 16.03 Authority of Investment Managers to Invest Funds
- 16.04 Use of Custodian Banks; Nominees; Securities Depository
- 16.05 Use of Brokers
- 16.06 Petitions for Additions to Legal List
- 16.07 Review of Investment Performance; Investment Managers
- 16.08 Procurement of Investment Related Services
- 16.09 Notice to Cease and Desist
- 16.10 Investment of Funds by Exempt Boards

840 CMR 16.00 is the standard rule for investment advice and management promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, § 50 and M.G.L. c. 32, §§ 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, 840 CMR 16.00 shall govern investment advice and management provided to any retirement board in the Commonwealth.

### 16.01 Definition

Unless a different meaning is plainly required by the context, words and phrases used in 840 CMR 16.00 through 25.00, shall have the meanings assigned them by 840 CMR 16.01. If no meaning is assigned by 840 CMR 16.01 they shall have the meanings assigned them by M.G.L. c. 32 and if no meaning is so assigned, they shall have their ordinary meanings.

**Person** means an individual, partnership, joint venture, corporation, association, trust, estate or organization of members of a retirement system.

**Qualified investment manager** means:

- (a) a person registered as an investment adviser pursuant to the Investment Advisers Act of 1940 (15 U.S.C. 80b - 1 et seq.);

(b) a bank as defined by the Investment Advisers Act of 1940;

(c) an insurance company qualified to manage, acquire, or dispose of assets of a plan pursuant to the laws of more than one state;

(d) a partnership, joint venture, corporation, association or trust in which the advisor or general partner is exempt from registration pursuant to 203(b)(3) of the Investment Advisers Act of 1940 (15 U.S.C. 80b - 1 et seq.)

## 16.02

### Employment of Qualified Investment Manager; When Permitted or Required; Delegation of Responsibility; Expenses; Contract

(1) Any board may employ a qualified investment manager as defined in 840 CMR 16.01 to advise the board on the purchase and sale of investments.

(2) Any board which has received an investment exemption pursuant to 840 CMR 19.00 shall employ a qualified investment manager or qualified investment managers who shall manage the funds of the system.

(3) No person who is not a qualified investment manager as defined by 840 CMR 16.01 shall advise any board on the purchase and sale of investments or manage the funds of any system which has received an exemption pursuant to 840 CMR 19.00.

(4) No board which has not received an exemption pursuant to 840 CMR 19.00 may delegate responsibility for the investment of the funds of the system provided, however, that any board may participate in or purchase units of the PRIT Fund.

(5) Employment of a qualified investment manager shall be by written contract executed prior to the delegation of investment authority to the qualified investment manager stating all terms and conditions of employment including, but not limited to, investment objectives, brokerage practices, proxy voting and tender offer exercise procedures, term of employment, fees and termination provisions. Every such contract shall provide that the qualified investment manager is a fiduciary with respect to the funds the board invests pursuant to the qualified investment manager's advice regarding the purchase and sale of investments or the funds which the qualified investment manager manages, as the case may be. No contract shall contain a provision which requires the indemnification of the manager by the retirement board. A copy of every contract shall be retained by the board and be subject to audit by the Commission.

(6) All qualified investment managers shall annually submit a current Form ADV Part II of the Uniform Application for Investment Adviser Registration to the board for which it manages assets and to the Public Employee Retirement Administration Commission.

## 16.03

### Authority of Investment Managers to Invest Funds

(1) Every board which has received an exemption pursuant to 840 CMR 19.00 shall by vote authorize a qualified investment manager as defined in 840 CMR 16.01 to invest and reinvest the funds of the system on behalf of the board in accordance with the board's statement of investment objectives.

(2) Every investment made by a qualified investment manager on behalf of a board shall comply with the requirements of M.G.L. c. 32, § 23 and 840 CMR 16.00 through 25.00.

## 16.04

### Use of Custodian Banks; Nominees; Securities Depository

(1) Every board shall designate one or more banks or trust companies, organized under the laws of the Commonwealth or of the United States, custodian of the securities and assets of the system, and shall designate as members of any nominee holding securities of the system any authorized employee of such custodian. All assets of the system shall be held by the custodian on behalf of the board. Each board shall direct its custodian to provide the Commission with the reports and information required pursuant to 840 CMR 4.00 and if possible, said reports and information shall be provided by electronic means or electronic access granted to the Commission.

(2) Any board may authorize a custodian designated pursuant to 840 CMR 16.04(1) to place the securities of the system in a securities depository registered with the Securities and Exchange Commission for the purpose of facilitating security trading and certificate delivery.

(3) In the event a board changes its custodian it shall make every effort to effectuate that change as of January 1.

## 16.05

### Use of Brokers

(1) Retirement system board members and employees shall not:

(a) direct brokerage commissions for services, or

(b) instruct its qualified investment manager or managers to direct brokerage commissions.

(2) Selection of brokers shall be based on competitive criteria including best price and

execution.

(3) Commission rates shall be negotiated.

(4) Board members shall review on an on-going basis all brokerage costs.

(5) Board members shall review on an on-going basis the selection of brokers and use of “soft dollars” (arrangements under which products or services other than execution of securities transactions are obtained from or through a broker in exchange for the direction of brokerage transactions to the broker) by its qualified investment manager or managers.

(6) Board members shall require the qualified investment manager or managers or brokers to disclose in writing to the board all commissions charged on all transactions and investments made.

(7) Board members shall require the qualified investment manager or managers or brokers to disclose in writing to the board mark-ups and mark-downs on all trades where the broker acted as dealer/principal.

(8) Notwithstanding the provisions of 840 CMR 16.00 boards may participate in so-called “commission recapture” programs provided that such participation is consistent with the board’s fiduciary duty and other provisions of 840 CMR.

## 16.06 Petitions for Additions to Legal List

Every board which petitions the Office of the Commissioner of Banks for inclusion of securities on the Legal List shall forward a copy of the petition and the final determination by the Commissioner of Banks as to inclusion on the Legal List to the Commission.

## 16.07 Review of Investment Performance; Investment Managers

(1) Every retirement board shall at least quarterly review the performance of the overall portfolio and selected components against the retirement system’s investment goals and policies.

(2) Every retirement board which has received an exemption pursuant to 840 CMR 19.00 shall meet with its qualified investment manager or managers at least annually and shall, at a minimum:

(a) require its qualified investment manager or managers to provide a comprehensive written quarterly report which includes a review of investment performance including a review of the investment manager’s relative performance, a review of the system’s investments, and a report on the investment manager’s current investment

outlook or forecast as well as strategy for the future;

(b) review each such report in depth with its qualified investment manager or managers; and

(c) require its qualified investment manager or managers to send one such report to the Commission each year.

(3) Every retirement board which has retained a qualified investment manager shall at least annually make a determination as to whether the manager continues to operate in the manner represented when retained and outlined in the agreement between the board and the qualified investment manager.

(4) Every retirement board which has retained a qualified investment manager shall require said manager to report key personnel staffing changes to the retirement board and the Commission on or before the effective date of such changes.

## 16.08 Procurement of Investment Related Services

The selection and hiring of investment managers, consultants, custodian banks and other investment related service providers by all retirement boards shall be subject to a competitive process which satisfies the boards' fiduciary duty and meets the requirements of M.G.L. c. 32 and 840 CMR. Prior to retention of the vendor Boards shall notify the Commission that such a process as well as the provisions of M.G.L. c. 32 and 840 CMR were adhered to. A procurement file for each such selection shall be maintained by the board and be subject to audit. Said file shall contain the request for proposals, selection process, selection criteria and other information relative to the board meeting its fiduciary responsibility with respect to the selection.

A person submitting a bid or proposal to provide services to a board shall certify, in writing, on the bid or proposal, as follows:

The undersigned certifies under penalties of perjury that this bid or proposal has been submitted in good faith and without collusion or fraud with any other person. As used in this certification, the word "person" shall mean any natural person, business, partnership, corporation, union, club, or other organization, entity or group of individuals.

---

(Signature of individual submitting bid or proposal)

---

(Name of business)

## 16.09

### Notice to Cease and Desist

If the Executive Director of the Public Employee Retirement Administration Commission has reason to believe that any person including, without limitation, any board or member or qualified investment manager thereof, has invested or is investing the funds of a system without authorization or in violation of any provision of M.G.L. c. 32, or 840 CMR 16.00 through 25.00, inclusive, the Executive Director shall issue a notice to such person to cease and desist from doing so and, if the Executive Director finds that protection of system funds so require, the Executive Director may:

- (1) remove any such person from advising any retirement system or managing the funds of any system;
- (2) revoke any exemption granted to such board pursuant to 840 CMR 19.00; or
- (3) petition the Superior Court to compel the observance and restrain the violation of any provision of M.G.L. c. 32, § 23, or 840 CMR 16.00 through 25.00.

## 16.10

### Investment of Funds by Exempt Boards

Notwithstanding the provisions of 840 CMR 19.00, retirement boards which have received an exemption in accordance with 840 CMR 19.00 may retain investment responsibility for sufficient assets necessary to cover current disbursements.

### Regulatory Authority

840 CMR 16.00: M.G.L. c. 7, § 50; c. 32, §§ 21 and 23.

# 840 CMR 17.00

## Standards of Conduct for Fiduciaries and Qualified Investment Managers

### Section

17.01 Bonding of Persons Having Access to Retirement Board Funds

17.02 Code of Ethics for Fiduciaries

17.03 Standards of Conduct for Fiduciaries

17.04 Standards of Conduct for Qualified Investment Managers

840 CMR 17.00, establishing standards of conduct for fiduciaries and qualified investment managers is promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, § 50 and M.G.L. c. 32, §§ 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, 840 CMR 17.00 shall govern the conduct of all retirement board fiduciaries and qualified investment managers. No person who is not a qualified investment manager as defined by 840 CMR 16.01 shall provide investment advice on the purchase and sale of investments to or manage the funds on behalf of any retirement system.

### 17.01

#### Bonding of Persons Having Access to Retirement Board Funds

All board members and retirement system staff shall be bonded in an amount sufficient to provide reasonable protection against losses due to fraud and dishonesty and each shall be bonded for no less than 10% of the amount of the fund or \$500,000. The Commission may prescribe a bond in excess of \$500,000, provided that such bond shall not exceed 10% of the amount of the fund.

### 17.02

#### Code of Ethics for Fiduciaries

Fiduciaries shall subscribe and conform to the following code of ethics:

(1) Fiduciaries shall conduct themselves with integrity and act in an ethical manner in their dealings with the public, retirement board, employers, employees, and fellow fiduciaries.

(2) Fiduciaries shall conduct themselves and shall encourage other fiduciaries to perform their functions in a professional and ethical manner that will reflect credit on themselves and their profession.

(3) Fiduciaries shall act with competence and shall strive to maintain and improve their competence and that of others in their profession.

(4) Fiduciaries shall use proper care and exercise independent professional judgment.

## 17.03 Standards of Conduct for Fiduciaries

Every fiduciary shall know and comply with all applicable provisions of M.G.L. c. 268A governing the conduct of public officials and employees and shall conform to the standards of conduct prescribed by M.G.L. c. 268A, § 23.

(1) Every fiduciary shall:

(a) Comply with the standards set forth in 840 CMR 1.00

(b) operate in accordance with retirement system procedures, documents and instruments; and

(c) inform each retirement system qualified investment manager of the Code of Ethics and Standards of Conduct applicable to qualified investment managers pursuant to 840 CMR 17.02 and 17.04.

(2) No fiduciary shall:

(a) receive additional compensation for services as a retirement board fiduciary if he or she is employed full-time by an employer whose employees are members of that retirement system except as otherwise provided by law;

(b) deal with retirement system assets for his or her own account or in his or her own interest;

(c) act in any manner affecting a retirement system on behalf of any person or organization whose interests are adverse to the interests of the system, its members or beneficiaries;

(d) receive anything of value for his or her own personal account from any person or organization in connection with a transaction involving retirement system assets; or

(e) cause a retirement system to engage in a transaction which involves, directly or indirectly, a sale, exchange, lease or transfer of assets to or from, or the use of assets



by or for the benefit of, or the furnishing of goods, services or facilities to or by, or the lending of money or extension of credit to or by, a party in interest. A party in interest includes:

1. any board member, fiduciary, employee, broker, agent or person providing services to the board;
2. any organization of members of the retirement system;
3. any corporation, partnership, or trust or estate of which or in which 10% or more of:
  - a. the voting stock or value of all stock of such corporation;
  - b. the interest in capital or profits of such partnership; or
  - c. the beneficial interest of such trust or estate is owned directly or indirectly by persons described in 840 CMR 17.03(2)(e)1.; and
4. any spouse, ancestor, lineal descendant, or spouse of a lineal descendant of any individual described in 840 CMR 17.03(2)(e)1.

## 17.04 Standards of Conduct for Qualified Investment Managers and Consultants

In addition to the standards of conduct for fiduciaries and the standards set forth in 840 CMR 1.00 Qualified Investment Managers shall comply with 840 CMR 17.04. 840 CMR 17.04 shall also apply to Consultants retained pursuant to 840 CMR 25.00.

### (1) Compliance with Applicable Law, Regulations, Code of Ethics and Standards of Conduct.

(a) Knowledge of and Compliance with Applicable Law, etc. Every qualified investment manager and every consultant shall be familiar with and comply with all applicable laws and rules and regulations, including rules and regulations of any self-regulatory agency of the profession, the standards of conduct of 840 CMR 17.03 and 17.04 and the code of ethics of 840 CMR 17.02.

(b) Assisting Legal and Ethical Violations Prohibited. No qualified investment manager or consultant shall knowingly participate in, or assist any act in violation of any statute or regulation governing securities matters or any act in violation of the code of ethics of 840 CMR 17.02 or the standards of conduct of 840 CMR 17.03 and 17.04.

(c) Use of Material Non-Public Information Prohibited. Every qualified investment manager and every consultant shall comply with all laws and regulations relating to

the use of material non-public information. No qualified investment manager or consultant shall communicate or take investment action on the basis of such information until it is publicly disseminated and any qualified investment manager or consultant who acquires such information, other than as a result of a special or confidential relationship with an issuer, shall make reasonable efforts to achieve public dissemination of such information by the issuer.

## **(2) Supervision of Employees**

Every qualified investment manager and every consultant shall exercise reasonable supervision over employees and agents subject to his or her control to prevent violation by such persons of applicable statutes, regulations, the code of ethics of 840 CMR 17.02 and the standards of conduct of 840 CMR 17.03 and 17.04.

## **(3) Investment Recommendations and Actions**

(a) Reasonable judgment. Every qualified investment manager and every consultant shall exercise diligence and thoroughness in making investment recommendations and/or in taking investment actions for a retirement board and shall:

1. have a reasonable and adequate basis for each investment recommendation and action, supported by appropriate research and investigation; and
2. maintain appropriate records to support the reasonableness of each investment recommendation and action.

### **(b) Portfolio Investment Recommendations and Actions**

Every qualified investment manager and every consultant shall, when making an investment recommendation or taking an investment action for any portfolio or retirement board, consider its appropriateness and suitability for that particular portfolio or board. In doing so, the qualified investment manager and consultant shall take into account the needs and circumstances of the board, the basic characteristics of the portfolio and the basic characteristics of the investment involved. Every qualified investment manager and every consultant shall use reasonable judgment in determining the factors to be considered and the weight to be given to each factor and shall distinguish between fact and opinion in presenting investment recommendations.

## **(4) Misrepresentation Prohibited**

No qualified investment manager or consultant shall make any statement, orally or in writing, which materially misrepresents the services that the qualified investment manager or consultant is capable of performing for the board, the qualifications of the qualified investment manager or consultant, the investment performance that the qualified investment manager has achieved or can be expected to achieve for the board or the expected performance of any investment. No qualified investment manager or consultant shall make any unsupported statement concerning these matters or any statement, orally or in writing, about any investment which guarantees or conveys any unsupported assurances, explicitly or implicitly.

**(5) Fair Dealing With Retirement Boards**

Every qualified investment manager and every consultant shall act in a manner consistent with the qualified investment manager's and consultant's obligation to deal equitably with a board when making investment recommendations, making material changes in prior investment advice, and taking investment action.

**(6) Priority of Transactions**

Every qualified investment manager and consultant shall conduct himself or herself in such a manner that transactions for the retirement board have priority over personal transactions, and that personal transactions do not operate adversely to the board's interest. A qualified investment manager making a recommendation about the purchase or sale of a security shall give the board adequate opportunity to act on the recommendation before acting on the qualified investment manager's own behalf.

**(7) Disclosure of Conflicts**

(a) Every qualified investment manager, and every consultant when making an investment recommendation or taking an investment action, shall disclose to Commission and the board in writing any conflict of interest the qualified investment manager or consultant may have and any beneficial ownership of the securities involved which could reasonably be expected to impair the qualified investment manager's or consultant's ability to render unbiased and objective advice.

(b) Every qualified investment manager, and every consultant shall disclose to the Commission and the board in writing all matters which could reasonably appear to interfere with the qualified investment manager's or consultant's duty to the board or ability to render unbiased and objective advice.

(c) Every qualified investment manager, and every consultant shall also comply with all requirements as to disclosure of conflicts of interest imposed by law and by rules and regulations of organizations governing the activities of investment advisors and shall comply with any prohibition of such activities if a conflict of interest exists.

**(8) Compensation**

**(a) Disclosure of Additional Compensation Arrangements**

Every qualified investment manager, and every consultant shall inform the Commission and the board of any arrangements, oral or in writing, for compensation or other benefit received or expected to be received by the qualified investment manager or consultant or a related person from others in connection with the qualified investment manager's or consultant's services to the board.

**(b) Disclosure of Referral Fees**

Every qualified investment manager and every consultant shall disclose to the Commission and the board any compensation paid or expected to be paid, directly or

indirectly, by the qualified investment manager or consultant or a related person to others for referring the services of the qualified investment manager or consultant to the board.

**(9) Relationships with Others**

**(a) Preservation of Confidentiality**

Every qualified investment manager and every consultant shall preserve the confidentiality of information communicated by the board concerning matters within the scope of the confidential relationship, unless the qualified investment manager or consultant receives information concerning illegal or potentially illegal activities on the part of any fiduciary or employee of the board. Any knowledge of illegal or potentially illegal activities on the part of any fiduciary or employee of the board shall be conveyed to all the members of the board and the Commission.

**(b) Maintenance of Independence and Objectivity**

Every qualified investment manager and every consultant, in relationships and contacts with an issuer of securities, whether individually or as a member of a group, shall use particular care and good judgment to achieve and maintain independence and objectivity.

**(10) Enforcement and Liability**

(a) Every qualified investment manager and every consultant shall be deemed to have agreed with the retirement board:

1. to be liable to the board for any losses due to any violation of the provisions of M.G.L. c. 32, § 23 or of 840 CMR 17.00 including without limitation, any violation of the code of ethics of 840 CMR 17.02 or the standards of conduct of 840 CMR 17.03 and 17.04;
2. to be subject to removal as a qualified investment manager or consultant by the Commission in the event that the Commission determines that the qualified investment manager or consultant has violated any of the provisions of M.G.L. c. 32, § 23 or of 840 CMR 17.00, including, without limitation, any provision of the code of ethics of 840 CMR 17.02 or the standards of conduct of 840 CMR 17.03 and 17.04; and
3. that neither the board nor the Commission shall be liable to the qualified investment manager or consultant for any such loss, by way of indemnity or otherwise, or for any such removal.

(b) No qualified investment manager or consultant removed by the Commission pursuant to 840 CMR 17.04(10)(a)2. shall continue to serve or be employed as a qualified investment manager or as a consultant by any other retirement board except as may otherwise be authorized by the Commission.

## Regulatory Authority

840 CMR 17.00: M.G.L. c. 7, § 50; c. 32, §§ 21 and 23.

# 840 CMR 18.00

## Formation of Investment Policy and Statement of Investment Objectives

### Section

18.01 General Requirement

18.02 Matters to be Included in Statement of Investment Objectives

18.03 Updates of Statement of Investment Objectives

840 CMR 18.00 is the standard rule for the formation of investment policy and statement of investment objectives promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, § 50 and M.G.L. c. 32, §§ 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, 840 CMR 18.00 is the standard rule for the formation of investment policy and statement of investment objectives.

### 18.01 General Requirement

(1) Every board shall file a statement of investment objectives with the Public Employee Retirement Administration Commission.

(2) Before designing an investment program and writing a statement of objectives, every board shall consider its most recent actuarial valuation, meet with the board's consultant, if any, and address the following questions:

- (a) What stage of growth best describes the system: start-up, early growth, sustained growth, maturity, or decline?
- (b) What are the estimates of growth in the workforce, benefit increases, inflation and other economic factors?
- (c) What is the projected level of cash payments to beneficiaries for the next 20 years (the "liabilities stream")?
- (d) What assumption regarding "real investment return" (total return less wage inflation rate) is used by the actuary to make funding estimates?
- (e) Is the system underfunded?

(f) What has been the history of employer and employee payments into the system? Is there any reason to expect that these will change?

(g) What is the long-term demographic forecast for the system area? What may affect the tax base including such factors as population and business growth, rate of growth or decline and condition of housing stock and industrial facilities?

(3) Asset allocation decisions shall be made based on a liability-sensitive approach which tailors asset allocation for the portfolio to the system's liability profile. Boards shall conduct an initial study of the asset universe and establish the asset allocation in a manner that recognizes the financial structure of the system. Asset allocation decisions shall establish target levels and ranges for asset percentages.

## 18.02

### Matters to be Included in Statement of Investment Objectives

Every statement of investment objectives shall be filed on Form 18, shall be signed by each board member and shall include the following information:

**(1) Fiduciaries**

The name, address, background and responsibilities of every retirement board fiduciary, including every qualified investment manager employed or expected to be employed by the board.

**(2) Terms of Employment and Compensation**

The terms of employment and compensation of every:

- (a) qualified investment manager;
- (b) consultant employed by the board;
- (c) custodian bank employed by the board;
- (d) actuary employed by the board;
- (e) attorney employed or used by the board; and
- (f) other contractor employed by the board.

**(3) Investment Policy**

A statement of investment policy indicating how investment objectives are to be accomplished including the investment philosophy and method of investment, whether a consultant will be employed, whether a qualified investment manager will be employed, the method to be used to select brokers on a competitive basis for investment transactions, guidelines for proxy voting and tender offer exercise procedures and other practices of the board.

**(4) Rate of Return**

A statement of the rate of return objective for each asset class and for the entire portfolio, provided that the statement also include the assumed rate of return used in the most recent actuarial valuation of the system. The rate of return objective for the entire portfolio should not exceed the assumed rate of return used in the most recent actuarial valuation of the system by more than 1.00%.

**(5) Risk**

The expected level of risk for the equity portion of the portfolio expressed in terms of an annual average beta coefficient, standard deviation, or other statistical risk measures and the expected duration of the fixed income portfolio. Risk levels shall also be established for other asset classes and the total portfolio.

**(6) Asset Mix**

The expected portfolio asset mix, expressed as a percentage of the entire portfolio, of equities, fixed income investments, cash and short term investments, real estate, alternative investments, and international investments.

**(7) Diversification**

The expected degree of diversification within each asset class for:

- (a) equities, including capitalization, industry diversification, number of issues and rate of turnover;
- (b) fixed income investments, including quality ratings, maturity schedule, industry diversification, number of issues, par value of issues and rate of turnover;
- (c) cash and cash equivalent investments, including types of instruments and insurance coverage;
- (d) real estate investments;
- (e) alternative investments such as venture capital and leveraged buy-outs;
- (f) international equities, including capitalization, country and industry diversification, number of issues and rate of turnover;



(g) international fixed income investments, including quality, maturity schedule, country and industry diversification, number of issues, par value of issues and rate of turnover; and

(h) international cash and cash equivalent investments, including country diversification, types of instruments and insurance coverage.

**(8) Other**

Such further information as may otherwise be required by the Commission.

## 18.03 Updates of Statement of Investment Objectives

Statements of objectives shall be updated by the board as changes occur including, but not limited to, the filing of an Application for Exemption as provided for in 840 CMR 19.00. The board shall notify Commission in writing of any such changes within ten days of the effective date of the change. Boards shall review and, if appropriate, amend the statement of objectives upon completion of each actuarial valuation of the system. In addition on or before December 31 of each year the board shall notify the Commission of whether or not any changes have been made in the statement of objectives and in the event changes have been made said board shall notify the Commission of those changes.

## Regulatory Authority

840 CMR 18.00: M.G.L. 7, § 50; c. 32, §§ 21 and 23.

# 840 CMR 19.00

## Exemptions From Investment Restrictions

### Section

- 19.01 Effect of Existing Exemptions
- 19.02 Complete Exemption by Commission
- 19.03 Revocation of Exemption
- 19.04 Determination of Qualifications of Investment Manager; Review of Application
- 19.05 Rating of Investment Performance and Qualifications

### 19.01

#### Effect of Existing Exemptions

(1) Any board which has received an exemption from restrictions on investments of M.G.L. c. 32, § 23(2)(b)(i) through (vii) on or before the effective date of 840 CMR 19.00 shall be deemed to have applied for and received an exemption for investment in the asset class which was the subject of the prior exemption. In the event any such board, following the completion of a competitive process as required by these regulations, selects a qualified investment manager appearing on a list of qualified investment managers promulgated by the Public Employee Retirement Administration Commission the board may retain said qualified investment manager without receiving a further exemption, provided, however, that the board has complied with other provisions of 840 CMR. Said list shall consist of all qualified investment managers which have been the subject of approved applications for exemption on or before the effective date of 840 CMR 19.00 and any qualified investment manager which is the subject of an approved application for exemption after that date.

(2) Boards shall use the following process in selecting qualified investment managers to invest in equity, fixed income, cash or cash equivalents. Boards shall establish specifications and criteria for selection including:

- (a) the total size of the portfolio to be managed by each prospective manager;
- (b) the number of managers that will be used for the total portfolio;
- (c) an initial determination as to whether existing managers will be retained automatically or reviewed as part of the overall selection process;
- (d) the type(s) of manager to be selected;

- (e) the size of the management firm desired;
- (f) the style or investment philosophy of the manager desired;
- (g) the methodology or investment process desired;
- (h) the range of fees that are considered tolerable;
- (i) the investment manager's use of soft dollar services; and
- (j) the manager's experience in policy restrictions including South Africa, Northern Ireland and tobacco restrictions.

(3) Boards shall use the following process in selecting qualified investment managers to invest in real estate. Boards shall establish specifications and criteria for selection including:

- (a) the total size of the portfolio to be managed by each prospective manager;
- (b) the type of real estate investment made by each qualified investment manager (unleveraged, leveraged, participating mortgage, straight-rate loans, or insured loans);
- (c) the construction stage of the properties (tenanted, rent-up phase, under construction or to be built);
- (d) the types of property to be selected (retail, office, residential or industrial);
- (e) the geographic distribution of properties (regional, limited geographic diversification, or national);
- (f) the number of properties to be selected by each investment manager; and
- (g) the range of fees that are considered tolerable.

(4) Real estate investments shall not exceed 5% of the total market value of the portfolio at the time of investment, provided that in any system with assets in excess of \$50,000,000, real estate investments may be made up to an amount equal to 10% of the total market value of the portfolio at the time of investment.

(5) Real estate investments shall be diversified by property type, geographic location and construction stage unless under the circumstances it is clearly prudent not to do so.

(6) No board shall invest in a group trust, limited partnership, or other form of pooled investment which invests in real estate if:

- (a) the board's investment would constitute more than 10% of the funds thereof;
- (b) the investments of all Massachusetts contributory retirement systems would constitute more than 50% of the funds thereof; or
- (c) more than 20% of the funds thereof are invested in a single investment.

(7) Boards shall use the following process in selecting qualified investment managers to invest in alternative investments:

- (a) Boards shall establish specifications and criteria for selection including:
  1. the total size of the portfolio to be managed by each alternative investment manager;
  2. the funding stage orientation (seed financing, start-up, other early stage, second stage financing, later stage financing, or other);
  3. the targeted industries or sectors;
  4. the location or region (geographic focus);
  5. target size of each investment, how much is generally invested and how much is kept in reserve;
  6. the range of fees that are considered tolerable, provided, however, that in no event shall a Board retain a qualified investment manager whose fee is based on a percentage of committed capital, provided, however, that such a fee may be paid for one year after the partnership commences operations, and provided further, that such a fee is paid by all investors;
  7. the expected return on investment.

(8) Alternative investments shall not exceed 3% of the total market value of the portfolio at the time of the investment provided that, in any system with assets in excess of \$25,000,000, alternative investments may be made up to an amount equal to 5% of the total market value of the portfolio at the time of investment.

(9) Alternative investments shall be diversified by funding stage, geographic location and targeted industries unless under the circumstances it is clearly prudent not to do so.

(10) No board shall invest in a group trust, limited partnership, or other form of pooled investment which invests in alternative investments if:

(a) the board's investment would constitute more than 10% of the funds thereof;

(b) the investments of all Massachusetts contributory retirement systems would constitute more than 50% of the funds thereof; or, more than 20% of the funds thereof are invested in a single investment.

(11) Boards shall select a qualified investment manager in accordance with competitive practices and shall notify the Commission that such practices were followed prior to contracting with a vendor and shall maintain a separate file for each such selection which details the process and which shall be subject to audit.

## 19.02 Complete Exemption by Commission

The Commission shall grant exemption from the restrictions on investment of M.G.L. c. 32, § 23(2)(b)(i) through (vii), inclusive as follows:

### (1) **Complete Exemption**

Boards assigned 70% or more of the total applicable points pursuant to the criteria developed in accordance with 840 CMR 19.05 shall be granted complete exemption.

### (2) **No Exemption**

Boards assigned less than 70% of the total applicable points pursuant to the criteria developed in accordance with 840 CMR 19.05 shall be granted no exemption.

(3) The Commission shall also consider other factors, including but not limited to, any regulatory action, litigation, or legal proceedings involving the qualified investment manager in the past five years and any other matters relating to the qualifications of the investment manager and shall determine whether any such matters warrant denial of an exemption. The Commission shall notify the board and the qualified investment manager of the reasons for any such denial of exemption. The Commission may withhold approval of an exemption if it is in the best interests of the retirement system.

(4) The Commission shall notify the board of its determination no later than ten days following receipt of all information needed to make such determination.

(5) The provisions of M.G.L. c. 32, § 23(2)(b)(i) through (vii) shall not apply to the retention of a qualified investment manager to invest assets of a board in fixed income securities or equities of United States Corporations provided those securities or shares are not an investment in alternative investments or real estate.

## 19.03

### Revocation of Exemption

(1) If the Commission has reason to believe that a board granted exemptions pursuant to 840 CMR 19.00, or the investments of any board, do not comply with the requirements of M.G.L. c. 32, § 23(2), or with the requirements of 840 CMR 19.00, the Commission may require the board to show cause why the exemptions should not be revoked. If the board fails to establish that its investments do so comply, the Commission may revoke the exemptions and the board shall thereafter be subject to the restrictions on investments of M.G.L. c. 32, § 23(2)(b)(i) through (vii).

(2) If the Commission determines that an action of a qualified investment manager, including but not limited to, involvement in any regulatory action, litigation or legal proceedings, change in principals or senior investment professionals, or performance significantly impairs or changes the manager's ability to perform, the Commission may remove the qualified investment manager from the list promulgated in accordance with 840 CMR 19.01.

(3) Any board upon revocation or withdrawal of an exemption shall annually file a report with the Commission which outlines which investments not authorized pursuant to the restrictions of M.G.L. c. 32, § 23(2)(b)(i) through (vii) are held by the board and why they continue to be held.

(4) In the event a qualified investment manager is no longer retained by any retirement board, the qualified investment manager shall be removed from the list promulgated in accordance with 840 CMR 19.01.

## 19.04

### Determination of Qualifications of Investment Manager; Review of Application

#### (1) **Investment Manager**

The Commission shall determine, for every application for exemption, whether the board has a qualified investment manager as defined by 840 CMR 16.01.

#### (2) **Review of Application**

If the Commission determines that the board has a qualified investment manager, the Commission shall review the selection process of the qualified investment manager, review the information contained in the application for exemption, consider the diversification of the investments of the board, and professional qualifications of the qualified investment manager in accordance with 840 CMR 19.05.

## 19.05

# Rating of Investment Performance and Qualifications

In rating investment performance and qualifications the Commission shall develop and disseminate objective criteria uniformly to be applied in an equitable fashion. These criteria shall include, but not be limited to, the investment performance of the system, investment performance of investment manager for asset classes which investment manager will manage, professional qualifications of investment manager, public and private pension accounts managed by investment manager as of the year preceding the year of application, registration of investment adviser under the Investment Advisers Act of 1940, investment manager's review and control procedures, daily supervision of portfolio and trading capability.

## Regulatory Authority

840 CMR 19.00: M.H.L. c. 7, § 50; c. 32, §§ 21 and 23.

(840 CMR 20.00: RESERVED)

# 840 CMR 21.00

## Prohibited Investments

### Section

#### 21.01 Prohibited Investments

840 CMR 21.00, establishing a list of prohibited investments, is promulgated by the Public Employee Retirement Administration Commission pursuant to M.G.L. c. 7, § 50 and M.G.L. c. 32, §§ 21 and 23. Except as may otherwise be provided by the Commission, or by supplementary rules of a particular retirement board approved by the Commission pursuant to 840 CMR 14.02, or by statute, 840 CMR 21.00 shall prohibit investments of retirement system funds invested pursuant to M.G.L. c. 32, § 23, whether or not exempt pursuant to 840 CMR 19.00.

### 21.01

#### Prohibited Investments

No investment by any board or by any bank pooled fund, mutual fund, group trust, limited partnership, insurance company separate account or other form of pooled investment of any board shall consist of any of the following:

- (1) Purchases of securities by partial payment of their cost (purchases on margin).
- (2) Sale of securities not owned by the system at the time of sale (short sales).
- (3) Future contracts other than as follows:
  - (a) Forward currency contracts may be written against securities in the international portfolio by an investment advisor registered under the Investment Advisors Act of 1940 and who has been the subject of an exemption for international investment.
  - (b) Forward currency contracts may be written against securities in an international portfolio to a maximum 25% of the international portfolio non-dollar holdings at market value. Speculative currency positions unrelated to underlying portfolio holdings are strictly prohibited.
- (4) Call options written against securities in the portfolio other than as follows:
  - (a) Call options may be written against equity securities (excluding international equities) in the portfolio by a qualified investment adviser registered under the Investment Advisors Act of 1940.
  - (b) Call options may be written against equity securities (excluding international



equities) in the portfolio to a maximum of 25% of the market value of the equity portfolio (excluding international equities).

(c) Only options listed on a U.S. registered exchange may be written.

(5) Purchases of options other than as required to close out options positions.

(6) Lettered or restricted stock (with the exception of those investments that are venture capital investments).

(7) Direct investment in mortgages.

(8) Collateral loans (with the exception of those investments that are leveraged buyout investments), provided, however that boards may participate in so-called “securities lending” programs through a custodian and provided, further, that the lending of securities is limited to brokers, dealers, and financial institutions and that the loan is collateralized by cash or United States Government securities according to applicable regulatory requirements.

(9) Loans to employees or individuals.

(10) Direct purchase or lease of real estate.

## Regulatory Authority

840 CMR 21.00: M.G.L. c. 7, § 50; M.G.L. c. 32, §§ 21 and 23.

(840 CMR 22.00: RESERVED)