



Minutes of the PRIM Administration and Audit Committee  
Thursday, February 6, 2020

Committee members present:

- Robert Brousseau, Chair
- Treasurer Deborah Goldberg
- Patrick Brock
- Karen Gershman, CPA via telephone
- Eileen Glovsky
- James Hearty
- Dennis Naughton via telephone
- Michele Whitham, Esq. via telephone

Committee members not present:

- Joseph Connolly
- Theresa McGoldrick, Esq.

The PRIM Administration and Audit Committee meeting was called to order at 10:02 a.m. The meeting was properly noticed as an open meeting but was without a full quorum physically present (five members were physically present and three participated remotely by phone, but a quorum requires six to be physically present).

**I. Approval of the Minutes (Voting Item)**

The approval of the minutes of the October 31, 2019, Administration and Audit Committee was postponed due to the lack of a full physically-present quorum.

**II. Executive Director / Chief Investment Officer Comments**

**a. Market and PRIT Fund Performance Summary**

Michael G. Trotsky, CFA, Executive Director and Chief Investment Officer, made comments to the Committee, including:

Calendar 2019 was a very strong and surprising year. What a difference a year makes. At this time last year, we discussed the challenging and volatile financial markets of calendar 2018. Particularly, the fourth quarter of 2018 was dismal with the S&P down 13.5%, and international markets similarly very weak. A 60/40 mix of stocks and bonds was down 7% in the December quarter of 2018 and down 5.6% for calendar year 2018. The PRIT Fund was down, but much less, down 1.8% (2.3% net of fees) for calendar 2018.

Last year at this meeting, we highlighted data that showed slowing global growth with many geopolitical and economic uncertainties. We discussed a U.S. economy still relatively strong, but slowing, and Europe, China and Japan slowing to a point where we were beginning to worry about contraction. We discussed weakening worldwide manufacturing trends, slowing earnings growth, weak retail sales, weak housing, weak consumer confidence, lower industrial material prices, and tight dollar liquidity. We discussed vulnerabilities in the global economy including tariffs and trade tensions with our trading partners and political gridlock and a “war-like” atmosphere in our government.

And indeed, many of our fears and predictions played out as worldwide economies slowed dramatically last year, some to the point of contraction. Trade tensions, lower material prices, weak consumer demand, tight dollar liquidity, and political infighting continues unabated. And despite our

recognition of the ominous conditions and just about everything we feared coming true, calendar 2019 was the second strongest year in the last 10 years at PRIM with the PRIT Fund up 16.6% (16.1% net), the S&P up more than 31%, DI markets up 22% and emerging markets up 23%. (The PRIT Fund was up 17.7% in 2017.) What's even more surprising, bonds were also very strong. We have often discussed that it is unusual for both the bond market and the equity markets to be simultaneously so strong. Usually falling yields and a strong bond market indicate that investors are fearful about future growth. Diversified bonds were up 9% and long bonds were up 21% in 2019, as yields fell. Today the 10-year Treasury is more than a full percentage point lower than this time last year, hardly a beacon of hope about future prospects.

The market has been climbing "the proverbial wall of worry" as the U.S. Federal Reserve Bank and central banks globally simultaneously implemented easing policies to stimulate their economies. The U.S. Federal Reserve Bank lowered rates three times during 2019. 2019 highlighted the "don't fight the Fed" philosophy that so many on Wall St. adhere to- the belief that the Fed has and will continue to protect our economy from an economic contraction. Some hope that this is the new normal. An investment manager recently wrote a research piece entitled, "*The End of the Boom-Bust Cycle as We Know It,*" a clear indication that some in the investment community think that this time is truly different. And these sentiments, coinciding with some more encouraging economic news, resulted in the large and impressive rally in stocks and bonds that defined calendar year 2019. But will this be the lasting inflection point leading to a sustained and strong worldwide recovery that is needed to sustain this market strength?

We are very grateful for such a strong year for the PRIT Fund even though we didn't anticipate such strong markets going into the year. Our performance of 16.6% gross (16.1% net) in calendar 2019 means that we added a staggering \$11.1 billion to the pension fund, which now stands at \$79 billion. That is 25% of the entire budget of the Commonwealth of Massachusetts of \$43.3 billion for fiscal 2020! Moreover, our performance over the last 1-, 3-, 5-, and 10-years is comfortably above our actuarial target return of 7.25%. The PRIT Fund trailing 10-year return, net of fees, is 8.6%. All this was accomplished while we have been strategically and gradually lowering our global equities exposure (lowering our risk profile) during the past 10-year market rally. It's really reassuring that our portfolio is performing so strongly in both up markets like CY2019 and down markets like CY2018.

Recently we acknowledged the strength in some recent economic news. For example, GDP growth was reported at 2.1% in Q4 and up 2.3% in 2019. This was better than we feared last year, however it was a slowdown from the 2.9% reported in 2018. The employment picture remains strong, inflation is low and in January, US manufacturing PMI showed strength, but that was after posting 5 straight quarters of contraction including hitting a decade low in December of 47.2.

However, we also highlighted some lingering risks. For example, a prominent economics firm reported the GDP growth rate in Q4 as, "*an optical illusion as the most recent three quarters mark the worst performance since the 2016 slump.*" They point out that 70% of the reported growth in the quarter was from an artificial boost caused by the trade calculation. Imports fell 9% in a period when exports increased by 1.4%. That gives the GDP an artificial boost of 1.5%, but falling imports are not necessarily a sign of continued and sustainable economic strength. Also, government spending was up 4.3% for the year, the highest spending growth since 2009. That adds to GDP growth, but business investment fell 1.5% in Q4 and consumer spending slowed to an annualized rate of 1.5% in Q4 versus 4% in Q2 and Q3.

Amid this uncertainty and some improving economic data we outlined six major points at the Investment Committee meeting on February 4<sup>th</sup> that give us confidence the PRIT Fund is appropriately

positioned while we watch the economic news for more confirming data to support recently rising equity markets. The six major points:

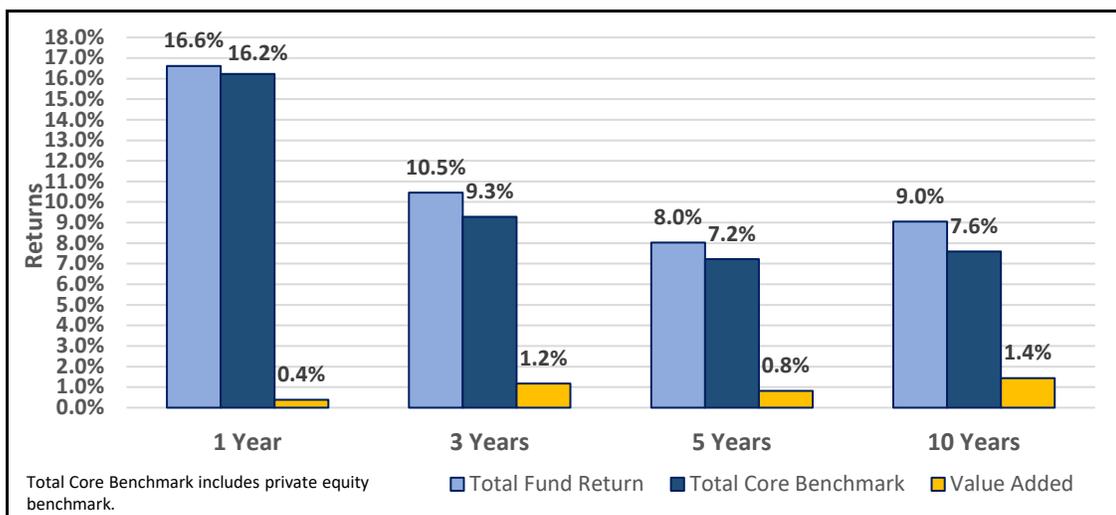
1. There is still a lot of positive spin being applied to the economic data releases. An example of which would be the Q4 GDP report described above.
2. Some economic indicators may appear to be bottoming, but it is off very low level and there is not a lot of room for economies to absorb a large shock.
3. Manufacturing still remains very weak across the board.
4. Hourly earnings growth and wage growth may not adequately support a consumer with the means to drive consumer spending, which is 70% of the U.S. economy.
5. A large part of the recent market rebound (especially in the second half of 2019) may have been fueled by the Fed’s aggressive intervention in the REPO market (a form of back door quantitative easing), which one expert described as “rocket fuel” for leveraged investors – Hedge Funds in particular.
6. The market remains narrow, with a few stocks, mainly tech stocks like Apple and Microsoft, propelling the markets higher. Material and industrial shares, international and emerging markets have been left behind.

In conclusion, we are pleased with the strong calendar year 2019 performance of the PRIT Fund, continue to believe it is appropriately positioned for the long run, and we will be watching closely for more confirming data to support the recently rising equity markets.

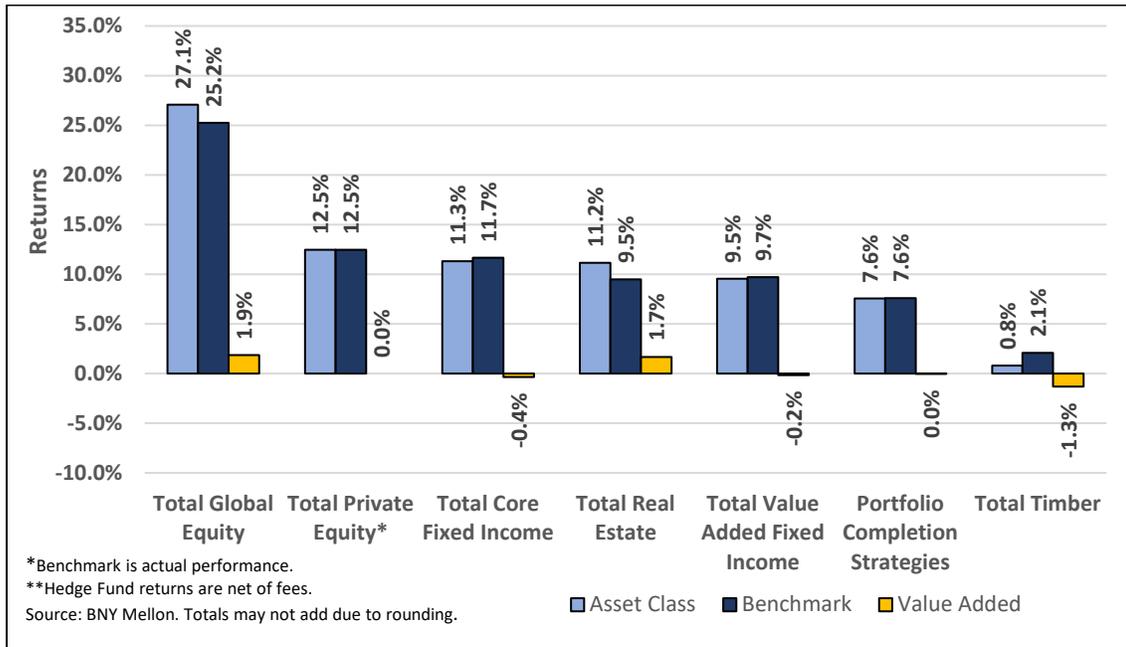
**PRIT Fund Performance Summary**

- As of December 31, 2019, the PRIT Fund net asset value stood at \$79.1 billion.
- For the one-year as of December 31, 2019, the PRIT Fund was up 16.6% (16.1% net), outperforming the total core benchmark of 16.2% by 39 basis points (-9 bps, net).
- This performance equates to an investment gain of \$11.5 billion (\$11.1 billion, net of fees).
- Net total outflows to pay benefits for the one-year ended December 31, 2019, were approximately \$1.3 billion.

**Total PRIT Fund Returns (Gross of Fees)**  
Annualized Returns as of December 31, 2019



**PRIT Asset Class Performance (Gross of Fees)**  
One Year Ended as of December 31, 2019



**Periodic Table of Returns by Asset Class (Gross of Fees)**  
Annualized Returns as of December 31, 2019

1 Year	3 Year	5 Year	10 Year
<b>GLOBAL EQUITY</b> 27.1%	<b>PRIVATE EQUITY</b> 20.3%	<b>PRIVATE EQUITY</b> 18.2%	<b>PRIVATE EQUITY</b> 18.2%
<b>PRIVATE EQUITY</b> 12.5%	<b>GLOBAL EQUITY</b> 12.9%	<b>REAL ESTATE</b> 9.0%	<b>REAL ESTATE</b> 11.0%
<b>CORE FIXED INCOME</b> 11.3%	<b>REAL ESTATE</b> 8.5%	<b>GLOBAL EQUITY</b> 8.9%	<b>GLOBAL EQUITY</b> 9.5%
<b>REAL ESTATE</b> 11.2%	<b>VALUE-ADDED FIXED INCOME</b> 6.7%	<b>VALUE-ADDED FIXED INCOME</b> 5.1%	<b>VALUE-ADDED FIXED INCOME</b> 6.8%
<b>VALUE-ADDED FIXED INCOME</b> 9.5%	<b>CORE FIXED INCOME</b> 5.2%	<b>TIMBER</b> 3.7%	<b>CORE FIXED INCOME</b> 5.1%
<b>TOTAL PCS</b> 7.6%	<b>TOTAL PCS</b> 4.5%	<b>CORE FIXED INCOME</b> 3.5%	<b>TIMBER</b> 5.1%
<b>TIMBER</b> 0.8%	<b>TIMBER</b> 3.9%	<b>TOTAL PCS</b> 3.1%	<b>TOTAL PCS</b> 4.5%

In December we announced two promotions. It is extremely satisfying for me to recognize and reward talented, hard-working staff members whose work enables us to remain a leader in our industry.

**Sarah Coelho was promoted to Senior Corporate Accountant.** Sarah joined PRIM as a Corporate Accountant in 2018. She quickly became a valuable member of the Finance team, where she has taken the lead on streamlining the quarterly close and annual budget processes. Sarah has taken on additional responsibilities after the retirement of Finance Manager, Cathy Hodges, and will soon be responsible for PRIM's benefits administration. Sarah's role will continue to expand in the finance and benefits areas. Sarah reports to Dan Eckman, Director of Finance and Administration.

**Maria Garrahan was promoted to Senior Investment Officer and Director of Research.** Maria joined PRIM as an Investment Officer in 2018. She has designed a thorough asset allocation framework, helped implement PRIM's proprietary suite of analytics across the organization, developed a data infrastructure playbook, collaborated on projects such as senior housing research with the Real Estate team and the Public Markets microcap research project, and she created the ESG Primer: "A Three Pillar Approach" which was presented at the Board retreat, and she continues to work on PRIM's ESG Framework. Maria and her team are responsible for coordinating investment research across all asset classes to help drive innovation at PRIM. She will be responsible for the buildout of the PRIM research team and she will continue to report to Eric Nierenberg, Ph.D., Chief Strategy Officer. The research team will become the third pillar of the Strategy group along with Risk, headed by Jay Leu, and PCS, headed by Bill Li.

**Sarah Zatoonian**, Investment Officer, Private Equity, recently passed the CFA Level I exam.

Real Estate Committee member, **Lydia Chesnick**, was recognized as one of Connect CRE's Women in Real Estate honorees. The organization selected inspirational women from around the country who play important roles in the real estate industry — because of their talent, drive and fresh ideas.

Also, I was honored on December 3, 2019 with **Institutional Investor Magazine's Lifetime Achievement** award at a ceremony in New York City. That was a great honor for me and entire PRIM staff and committee and Board members, whose work enabled the recognition. It was recently pointed out to me that with nearly 10 years as Executive Director, I am the longest serving Executive Director (and Chief Investment Officer) in PRIM's history. It has been a very rewarding experience. But as I said before, I feel like we are just getting started.

Also, on a more personal level, in December I was named a Governing Trustee on the **Dana Farber Cancer Institutes' Board**. I would like to thank Treasurer Goldberg for her support and for her endorsement as I went through Dana Farber's screening and selection process last fall. I am extremely excited to give back to an institution that is one of the world's finest cancer centers. The Dana Farber is near and dear to me and my family. I can't be more thrilled to help in any way I can to help maintain Dana Farber's world-class status and to continue to make its leading-edge treatments available to those in need. It is a humbling honor that I will relish.

#### **b. Summary of 2020 Annual Plans**

Mr. Trotsky told the Committee that each year, each senior staff member and each asset class head prepares an annual plan. Mr. Trotsky noted that PRIM's 2020 Investment Team's Annual Plans were presented at the Investment Committee on February 4, 2020, and to the Real Estate and Timberland Committee on February 5, 2020, for feedback and comment so that the plans may then be presented to the Board for its feedback and comment.

Mr. Trotsky told the Committee that PRIM staff would summarize PRIM's 2020 Finance and Administration, Investment Operations, Technology, Legal Services, and Client Services Annual Plans

for the Committee and would revise the plans as appropriate to incorporate feedback received from the Committee and then present the plans to the Board at its February 26<sup>th</sup> meeting.

Anthony Falzone, Chief Operating Officer, discussed annual plans that were especially appropriate for consideration by the Administration and Audit Committee. Key points included:

#### **2019 Finance and Administration Accomplishments**

- The team created a diversity and inclusion framework to help with the execution of PRIM's many diversity and inclusion initiatives including recruitment, retention, procurement, and training.
- The team issued and successfully completed three RFPs (audit and tax services, operational due diligence services, and hedge fund managed account platform provider services).
- We successfully completed disaster recovery/business continuity testing and technology security testing with no major findings.
- We developed webinar capabilities that will provide educational opportunities for the Board, committees, and staff.

Several Committee members mentioned the need for robust security controls and disaster recovery capabilities, specifically Eileen Glovsky, who asked for more detail around PRIM's disaster recovery and technology security testing. Mr. Falzone explained that the areas of disaster recovery, business continuity, and technology security are a major focus and that PRIM staff uses the same diligence and tenacity when reviewing and auditing these critical areas as the financial statement audits and CAFR presentation. He told the Committee that he is proud of the work PRIM has done in these areas and that it is challenging to have the optimal blend of security and functionality.

Mr. Falzone told the Committee that PRIM continues to evolve its technology security using best practices and has expanded its relationship with Rapid7, the firm that performs the security audits. He also mentioned that 98% of the organization is provided laptops and the environment utilizes cloud and virtual desktops to create extremely robust remote work capabilities and that PRIM also spends a good amount of time reviewing its vendor's security policies and disaster recovery capabilities.

#### **2020 Finance and Operations Annual Plan Highlights**

- Continue the work done to enhance diversity, equity and inclusion, and report more metrics on PRIM's progress.
- Evaluate tools to help manage the Human Resource function (HRIS).
- PRIM will be administering the 2020 PRIM Board Elections for the state employees' and teachers' Board seats (SERS and STRS)
- Onboard the Operational Due Diligence (ODD) provider and design a standardized ODD policy that covers all asset classes.
- Issue the RFP for global custodial services.
- Roll out PRIM's new website and social media platform and re-brand PRIM's Board and committee materials as well as our charts and presentations.
- Collaborate with PRIM's research team to develop a data warehouse.
- Onboard and deploy electronic Board and committee packages.

Before moving into the Legal and Client Services annual plans Eileen Glovsky mentioned that diversity and inclusion should permeate through all areas of management and be part of its strategy not just part of Finance or Human Resources. Mr. Falzone explained that much like Project Save, diversity and inclusion is becoming part of PRIM's DNA, and it is being practiced in many of PRIM's internal processes. Mr. Falzone added that he is currently working with Eric Nierenberg, Ph.D., PRIM's Chief

Strategy Officer on several diversity and inclusion projects including reviewing PRIM's office footprint to determine if it can be improved to foster more collaboration and inclusion.

### **2019 Legal Accomplishments**

The Legal team worked on approximately 13 Private Equity co-investments, 14 PCS separately managed accounts, and many other investment management agreements, vendor contracts, non-disclosure agreements, RFPs and the like. The Legal team also worked closely with the Client Services team on the MBTA Retirement Board proposal that ultimately led to the MBTA Retirement Board investing in PRIM's Hedge Funds and Private Equity portfolios.

### **2020 Legal Services Annual Plan**

The Legal Services annual plan does not tend to change all that much from year to year mainly because legal work falls into the areas of contract review, litigation, government law issues, etc. In 2020 it will be more of the same with particular focus on the increase in direct investing including expanded co-investing and internal trading strategies, and increased use of the separately managed account structure.

### **2019 Client Services Accomplishments**

The Client Services team traveled extensively throughout the state meeting with clients, 83 meetings in all, including the MBTA Retirement Board. In addition to many meetings, the Client Services team created an RFP response process and template that allows PRIM to respond to RFPs making it easier for potential clients to evaluate PRIM in line with other investment providers.

### **2020 Client Services Annual Plan**

The Client Services annual plan does not tend to change all that much from year to year. The Client Services team will continue to strengthen current client relationships by continuing to meet in-person with clients and prospective clients.

## **III. 2020 Proxy Voting Guidelines (Voting Item)**

Ellen Hennessey, Compliance Analyst, joined Mr. Falzone along with representatives from PRIM's proxy voting consultant, Institutional Shareholder Services (ISS), participating via conference call: Mikayla Kuhns and Michael Crovetto. Ms. Hennessey reviewed the enhancements made to PRIM's proxy voting guidelines in 2019, along with PRIM's proxy voting statistics in several key areas including but not limited to board diversity and over-boarding.

Representatives from ISS presented changes to their broader proxy voting policy along with several changes to PRIM's custom policy for 2020. PRIM's proposed changes were as follows:

- Current Guideline: Vote AGAINST/WITHHOLD from all board nominees if less than 30 percent of the board is diverse in terms of gender and race.
- Proposed Change: Vote AGAINST/WITHHOLD from all board nominees if less than **35** percent of the board is diverse in terms of gender and race.

Proposed NEW guidelines: Prohibit Discrimination on the Basis of Disability (new section in proxy voting guidelines).

- Vote FOR shareholder proposals to include language in EEO statements specifically barring discrimination on the basis of disability.
- Vote FOR shareholder proposals requiring the company to demonstrate that their reasonable accommodation policy is in accordance with the Americans with Disabilities Act and State Disability Law, and is available to all employees and can be accessed in more than one way.

- Vote FOR shareholder proposals seeking reports on a company's efforts to include Disability-Owned Business Enterprises (DOBE®), Service-Disabled Veteran Disability-Owned Business Enterprises (SDVDOBE™), and Veteran Disability-Owned Business Enterprises (V-DOBE™) in their supplier diversity program.
- Vote FOR proposals requesting an internal and external audit of website compliance under the World Wide Web Consortium's Web Content Accessibility Guidelines 2.1 (W3C WCAG 2.1).

Proposed NEW guideline: Safety and Security in the Workplace (under Equal Employment opportunity section)

- Vote FOR shareholder proposals banning guns on company property, except for security related uses, including parking lots on property.

Dennis Naughton asked for clarification on the proxy voting policy update related to Share Repurchase Programs. After some discussion Mr. Naughton was satisfied with the proposal and expressed his support but requested that PRIM staff and ISS provide him with additional background information on the Share Repurchase Program policy update sometime after the meeting.

PRIM staff and a consensus of the Administration and Audit Committee recommended that the PRIM Board adopt the 2020 enhancements to PRIM's Custom Proxy Voting Guidelines as described in Appendix G.

#### **IV. Results of PRIM Board Self-Evaluation**

Mr. Falzone and Robert Brousseau, Chair, introduced Tom Iannucci, President of Cortex Applied Research, Inc. (Cortex), who joined the meeting by telephone. Mr. Brousseau presented the Committee with the results of the PRIM Board self-evaluation.

Some key points Mr. Brousseau discussed were as follows:

- There was 100% Board member participation. All nine Board members completed the survey and seven Board members also submitted additional comments by telephone.
- All Board members provided a highly positive assessment of the performance of the Board, PRIM management, and staff. The Board assessed all issues in the survey positively.
- Of the 473 responses provided, 87% were very positive (e.g., 4 or 5 on a 5-point scale).
- The need to continue focusing on succession planning with the Executive Director and other senior staff.
- Increase the number of Board education opportunities and/or meetings.
- A Board member suggested increasing the number of opportunities for Board members to socialize together and strengthen relationships.
- Aim to ensure maximum (100%) attendance at Board retreats.
- Consider having staff provide a short report to the Board periodically on activities involving stakeholders.

Mr. Falzone told the Committee that PRIM staff will create a formal response to the Board self-evaluation and will present that response to the Administration and Audit Committee at its next meeting and incorporate any feedback it receives. PRIM staff will then provide the Board self-evaluation response to the PRIM Board at its May 21, 2020 meeting.

## **V. Issuance of a Request for Proposals for Global Custody Services (Voting Item)**

Mr. Falzone informed the Committee that PRIM's contract with BNY Mellon, the incumbent custodian, expires on June 30, 2021. While it is early, this is a significant undertaking and for this process to be done in a thoughtful and thorough manner staff will need as much runway as possible.

It was the consensus of the Administration and Audit Committee members present, and the PRIM staff, to recommend to the PRIM Board that they approve the issuance of a Request for Proposals for Global Custody Services.

## **VI. Legal/Legislative Update**

PRIM's General Counsel introduced Emily Kowtoniuk, Deputy Director of Policy and Legislative Affairs, Office of the Treasurer and Receiver General, who provided the Committee with an update on several legislative proposals and their status in the legislative process.

Treasurer Deborah Goldberg distributed an article from the Boston Globe, written by Jon Chesto titled "Local legal, VC industries take big steps to diversify the leadership ranks".

## **VII. Other Matters:**

The Committee members briefly discussed the following topics:

- a. December 2019 PRIM budget
- b. Travel
- c. Client Service Update

The PRIM Administration and Audit Committee meeting adjourned at 11:46 a. m.

### List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Administration and Audit Committee Meeting of October 31, 2019*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *2020 PRIM Staff Annual Plans*
- *2019 Proxy Voting Review*
- *ISS' 2020 Global Benchmark Policy Updates*
- *PRIM Custom Policy Matrix – 2020 Proxy Voting Policy Update*
- *December 2019 PRIM Operating Budget*
- *Travel Report*
- *Asset Allocation Chart*
- *Cortex – Board Self-Evaluation Summary*
- *Boston Globe Article - "Local legal, VC industries take big steps to diversify the leadership ranks"*