



Minutes of the PRIM Administration and Audit Committee
Monday, April 30, 2018

Committee members present:

- Robert L. Brousseau, Chair
- Treasurer Deborah B. Goldberg arrived at 10:17 a.m.
- Patrick E. Brock
- Eileen Glovsky
- James Hearty
- Dennis J. Naughton
- Michele A. Whitham, Esq.

Committee members not present:

- Ted C. Alexiades, CPFO
- Joseph A. Connolly
- Karen E. Gershman, CPA
- Theresa T. McGoldrick, Esq.

The PRIM Administration and Audit Committee meeting was called to order at 10:08 a.m.

I. Approval of Minutes (Voting Item)

The PRIM Administration & Audit Committee unanimously, with Patrick E. Brock abstaining, approved the minutes of its February 1, 2018, meeting.

II. Interim Meeting with PRIM Board Auditors

Anthony J. Falzone, Chief Operating Officer, introduced Dave Gagnon, KPMG Audit Partner, PRIM's lead engagement partner, and Jen Serrano, KPMG Audit Manager. Mr. Falzone explained that representatives from KPMG were present to review the following:

- The audit plan for the Fiscal Year 2018 PRIM Board and PRIT Fund audits
- The plan for the agreed upon procedures review of PRIM's procurement process and performance benchmarks
- The December 31, 2017 year end audits for the following alternative asset classes
 - The entire Real Estate portfolio (10.0% target, 8.5% actual)
 - Audit procedures on PRIM's non-core and REIT investments
 - PRIT's Timberland portfolios (4% target, 3.5% actual)
 - PRIT's 15 directly managed separate accounts (4% of the total fund)
 - PRIT's 14 directly managed hedge fund portfolios
 - PRIT's sole Other Credit Opportunities portfolio
- PRIT's sole Agricultural portfolio

Mr. Gagnon and Ms. Serrano updated the Committee on the audit plan, which includes the KPMG team and planned test work, for the June 30, 2018, audits of PRIM and the PRIT Fund. Mr. Gagnon noted that the June 30, 2018, audited financial statements of PRIM, the PRIT Fund and the Comprehensive Annual Financial Report (CAFR) will be presented at the November 2018 Committee meeting.

Mr. Gagnon informed the Committee that the PRIT Core Realty Holdings, LLC (PRIT Core Realty) financial statements audit as of December 31, 2017, resulted in an unqualified opinion. This audit, which is required due to PRIM's real estate leverage program, encompasses the PRIT Fund's entire real estate asset sleeve

including core and non-core properties, commingled fund investments and real estate investment trust (REIT) securities.

Mr. Gagnon noted that the audit of the timberland portfolio managed by the Campbell Group resulted in an unqualified opinion while the audit of the other timberland portfolio, managed by FIA, is underway and the reporting deadline is expected to be met without issue.

Mr. Gagnon updated the Committee on the Hedge Fund and PCS managed account portfolio audits. This was the third year of these audits and all portfolios resulted in unqualified opinions.

Mr. Gagnon noted that the audit of PRIT's sole agricultural portfolio was ongoing and was asked about the valuation process for the PRIT Fund's agricultural assets. He noted that, since such assets are real estate-based, many aspects of the valuation process are similar to that applied to commercial real estate. Qualified agricultural appraisers are used; however, such appraisers normally make additional assumptions regarding crops, including harvesting costs, projected yields, product demand, etc., which by comparison to commercial real estate makes the valuation exercise more extensive. For example, although land, related improvements, and buildings are often able to be valued using comparable market data, the income approach (i.e., discounted cash flow projections) incorporating the crop assumptions may be necessary to value the agricultural component. That said, comparable sales data on a per-acre basis for similar agricultural assets may be available (for example, a vineyard located in the same region producing similar grapes) and may be used in estimating fair value.

Mr. Gagnon described to the Committee the latest Peer Review Report on KPMG's system of quality control. He noted that the review occurs every three years and is performed by PWC. The American Institute of CPAs (AICPA) governs the peer review program. He noted that KPMG's engagement letter includes as an attachment the Peer Review Report, KPMG's response, and the AICPA's letter of acceptance.

Treasurer Goldberg arrived at 10:17 a.m.

III. Executive Director/Chief Investment Officer Report

Michael G. Trotsky's, CFA, Executive Director and Chief Investment Officer, comments to the Committee included:

Organizational Update

Earlier this month PRIM began an in-depth study on diversity and inclusion, which will outline and help us plan any needed actions. Anthony J. Falzone, Chief Operating Officer, Deb Coulter, CPA, Chief Financial Officer, and Christina Marcarelli, Investment Officer are working closely with outside consultants from IBIS Consulting Group to conduct this organizational assessment. Anonymous surveys were completed in mid-April, and in mid-May IBIS will conduct in-person interviews. PRIM chose IBIS because of their 30 years of experience combined with their unparalleled knowledge of emerging best practices. The more we can embrace differences within PRIM—diversities of thinking style, experience, race, gender, sexual orientation, faith, ability and more—the better we can serve the diverse citizens of Massachusetts, both now and in the future. PRIM staff will report back to the Committee at future meetings.

Mr. Trotsky and Christina Marcarelli will be traveling to NYC in May to participate in the CFA Institute's Diversity and Inclusion roundtable event. After Mr. Trotsky's term ended as a Governor of the CFA Institute last September, he was asked to join an advisory committee of CEOs, CIOs, and other investment industry executives from across the nation to develop a best practice guide for companies in the investment industry to use to increase diversity in the investment industry. The investment industry lags most others in terms of diversity, but industry leaders are finally banding together and are very serious about addressing the issue. Mr. Trotsky noted that he would be able to share some of the results of this

work this fall. Mr. Trotsky mentioned that working on this project with the CFA Institute and other CEOs across the country has been a very fulfilling activity for him.

Mr. Trotsky stated that increasing the diversity of PRIM staff is a priority and demonstrated PRIM's recent successes. He added that of the 6 new hires over the last 12 months, 5 are diverse in either race, gender or both. He added that the intern pool at PRIM is equally as diverse. Of the 5 interns hired last year, all were diverse in either race, gender or both. PRIM is planning to add another 5 interns this year and they are all diverse in either race, gender or both, with all 5 intern candidates in this year's class being women.

Mr. Trotsky reminded the Committee that PRIM's experience shows that turnover and recruitment efforts disproportionately affect diverse candidates because all private sector employers in the investment industry are targeting diverse candidates and the pool from which to choose is not large. It is hyper-competitive for diverse employees in this industry.

Mr. Trotsky concluded his organizational update by providing an update on the ongoing searches for three open positions at PRIM, Director of Human Resources, Director of Information Technology, and Private Equity Investment Analyst. Mr. Trotsky informed the Committee that The Director of Human Resources and the Director of Information Technology searches are nearly complete, with the Private Equity Investment Analyst not very far behind.

PRIM received approximately 585 applications for these three positions and Mr. Trotsky told the Committee there is no greater compliment that PRIM can receive—to receive so many highly qualified applicants.

Ms. Glovsky asked questions regarding the screening process for candidates. Mr. Falzone indicated that it often can depend on the position, but generally speaking, PRIM uses a firm to gather metrics of all applicants and screens resumes based on a variety of factors determined by the needs of the organization. These factors can include experience, education, past work history, industry knowledge, etc.

Market Summary

Mr. Trotsky stated that while the final quarter of 2017 was strong, and it capped an outstanding year in the financial markets, the first calendar quarter ended March was more volatile, and markets were down. Domestic stocks were down, developed international equities were down, and bonds were down as yields and interest rates continued to rise modestly. A 60/40 mix of stocks and bonds, a common benchmark for diversified portfolios, was down more than 1% in the quarter. The lone bright spot was in Emerging Markets equities, which were up 1.3% in the quarter. The commitment to EM equities served PRIM well; it was the only equity sleeve that wasn't cut last year in PRIM's asset allocation decisions.

PRIT Fund Performance Summary

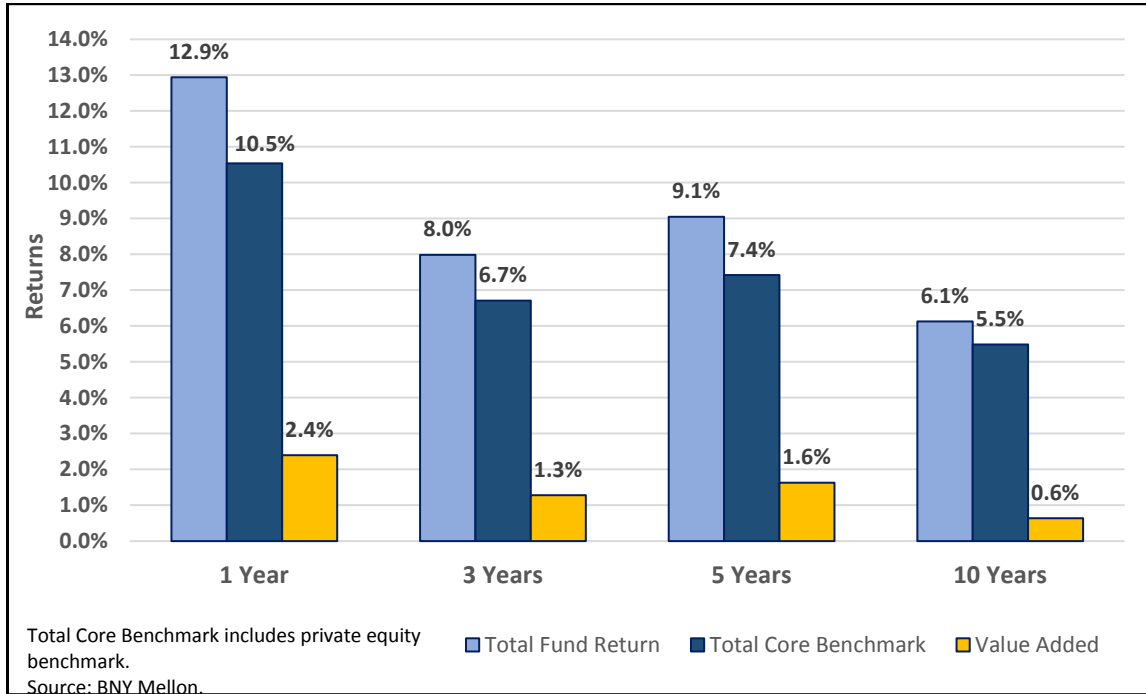
The PRIT Fund performed very well in the first quarter of 2018. For the quarter, the PRIT Fund was up 0.6% gross, or 0.5% net, outpacing the benchmark by 23 basis points. Mr. Trotsky mentioned earlier that a 60/40 split of stocks and bonds was down 1.3% in the quarter and staff have reason to believe that PRIM's performance will be very strong competitively.

Mr. Trotsky reminded the Committee that this outperformance was achieved with a significantly lower risk profile than PRIM's peers, who on average have a 50% allocation to global equities, versus PRIM's 40% allocation. PRIM is thankful for that very strong performance in an up market, but what is even more telling is that in the last 12-month downturn, which occurred when global equities were down more than 5% in our fiscal year 2016, PRIM was up 2.3%, while most other funds were either flat or down. PRIM knows of no other fund in the country PRIM's size or larger that performed better in the down market of fiscal year 2016. PRIM also significantly outperformed the endowments and foundations in those same years. This shows that PRIM's carefully constructed and de-risked portfolio is working exactly as intended,

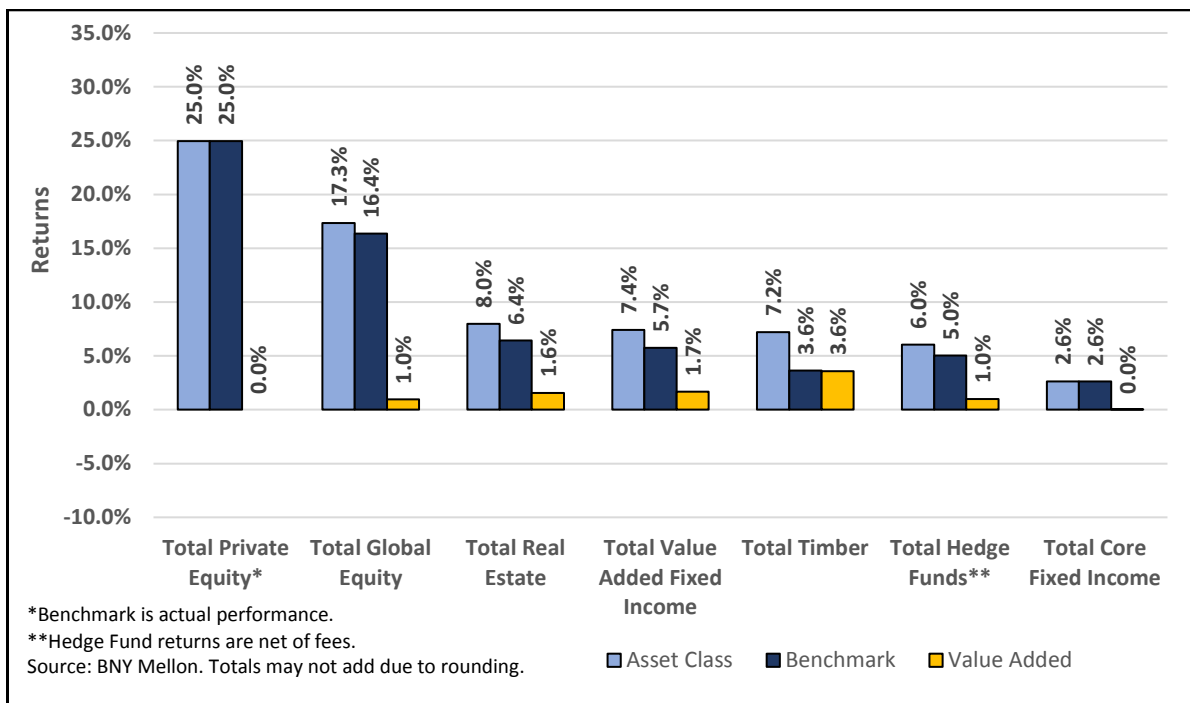
providing us with substantial outperformance in both challenging markets (down markets) like FY16, and Q1 of this year, and in rewarding markets (up markets) like CY17.

Mr. Trotsky made reference in his remarks to the following charts:

Total PRIT Fund Returns (Gross of Fees)
Annualized Returns as of March 31, 2018



PRIT Asset Class Performance (Gross of Fees)
One Year Ended March 31, 2018



PRIT Core Fund Performance Summary
Gross of Fees Performance

Trailing 1-Year Performance as of March 31, 2018 (Gross of Fees)

| Trailing 1-Year Performance: March 31, 2018 | Return | Benchmark Return | Over/(Under) Benchmark (bps) | \$Value (millions) | % of PRIT Fund |
|--|--------------|---------------------|------------------------------------|-----------------------|----------------------|
| Total PRIT Fund | 12.9% | 10.5% | 240 | 71,628 | 100% |
| Total Global Equity | 17.3% | 16.4% | 96 | 30,984 | 43.3% |
| <i>Domestic Equity</i> | <i>14.3%</i> | <i>13.8%</i> | <i>49</i> | <i>13,390</i> | <i>18.7%</i> |
| <i>International Developed</i> | <i>16.8%</i> | <i>15.8%</i> | <i>100</i> | <i>12,396</i> | <i>17.3%</i> |
| <i>Emerging Markets</i> | <i>26.5%</i> | <i>24.9%</i> | <i>169</i> | <i>5,198</i> | <i>7.3%</i> |
| Private Equity | 25.0% | 25.0% | 0 | 7,536 | 10.5% |
| Real Estate | 8.0% | 6.4% | 155 | 6,121 | 8.5% |
| Total Timberland | 7.2% | 3.6% | 357 | 2,548 | 3.6% |
| Hedge Funds | 6.0% | 5.0% | 100 | 5,944 | 8.3% |
| Value Added Fixed Income | 7.4% | 5.7% | 168 | 5,855 | 8.2% |
| Core Fixed Income | 2.6% | 2.6% | 2 | 9,122 | 12.7% |

PRIT Asset Class Performance (Gross of Fees)

Annualized Returns as of March 31, 2018

| 1 Year | 3 Year | 5 Year | 10 Year |
|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| PRIVATE EQUITY 25.0% | PRIVATE EQUITY 19.1% | PRIVATE EQUITY 19.6% | PRIVATE EQUITY 13.1% |
| GLOBAL EQUITY 17.3% | GLOBAL EQUITY 9.3% | REAL ESTATE 10.5% | VALUE-ADDED FIXED INCOME 7.0% |
| REAL ESTATE 8.0% | REAL ESTATE 8.8% | GLOBAL EQUITY 9.9% | REAL ESTATE 6.5% |
| VALUE-ADDED FIXED INCOME 7.4% | VALUE-ADDED FIXED INCOME 5.7% | TIMBER 6.8% | GLOBAL EQUITY 6.5% |
| TIMBER 7.2% | TIMBER 5.0% | HEDGE FUNDS (NET OF FEES) 4.8% | TIMBER 4.4% |
| HEDGE FUNDS (NET OF FEES) 6.0% | HEDGE FUNDS (NET OF FEES) 2.5% | VALUE-ADDED FIXED INCOME 4.4% | CORE FIXED INCOME 4.1% |
| CORE FIXED INCOME 2.6% | CORE FIXED INCOME 0.7% | CORE FIXED INCOME 3.4% | HEDGE FUNDS (NET OF FEES) 3.4% |

Mr. Trotsky made the Committee aware that more detail would be provided at the Investment Committee meeting, and that more information was included in the Administration and Audit Committee package.

IV. Massachusetts State Audit Results

Mr. Falzone updated the Committee on the results of the performance audit of the PRIM Board for the period July 1, 2015 through June 30, 2017, conducted by the Massachusetts Office of the State Auditor. Mr. Falzone noted that the Official Audit Report conveyed no findings and offered no recommendations. He expressed gratitude to all staff for their hard work and mentioned that PRIM should be very proud of the audit results.

V. Draft Fiscal Year 2019 Operating Budget (Voting Item)

Mr. Falzone and Deb Coulter, CPA, Chief Financial Officer, presented the Draft Fiscal Year 2019 PRIM Operating Budget. Ms. Coulter thanked Dan Eckman, CPA, Director of Finance and Administration, and Cathy Hodges, Senior Manager of Finance, and the rest of the team for its work on the proposed budget.

Mr. Falzone noted the total Fiscal Year 2019 Budget is projected to be \$406 million or 55 basis points (bps) of the projected average PRIT Fund assets of \$74 billion, which is a 15.6% increase compared to last years projected average assets of \$64 billion. Most of PRIM's fees relate directly to PRIM's assets, so higher average assets results in higher fees. As a result, the Fiscal Year 2019 budget is 13.2% or \$47.3 million larger than Fiscal Year 2018's Budget, but in basis points, the budget decreases from 56.1 bps to 54.9 bps – a 2.2% decrease – meaning collectively PRIM is paying less fees to manage more assets.

Mr. Falzone explained the budget is comprised of 3 sections: Investment Management Fees, Third-Party Service Providers and Operations. Investment Management Fees comprise approximately 92.9% of the total budget. These fees are paid to investment managers to invest the assets of the PRIT Fund. These fees are grouped by asset class. The PRIT Fund's asset allocation drives the fee structure.

Mr. Falzone referred to graphs on page 3 of the budget that show the relationship between PRIM's asset allocation and PRIM's budget allocation. He noted that the size of an asset allocation does not directly relate to the size of the expense. For example, the Global Equities target asset allocation is 39% of the PRIT Fund, the largest asset class – yet only requires 18% of the total budget. This is due to the availability and use of passive management for much of the global equities portfolio, which is inexpensive to implement. Contrast that with Private Equity, PRIM's highest returning asset class, and with a 12% allocation now, which was just increased from 11% at the February Board meeting, is an expensive asset class, and therefore requires 28% of our FY 2019 budget to implement it successfully. Through Project SAVE, staff has worked to drive down these costs.

Mr. Falzone went on to explain that this budget is based on continued asset growth, using NEPC's 5-7-year growth assumptions (6.6%), however, future performance is not predictable, so PRIM's actual fees will vary, but PRIM's budget gives a very good approximation of projected expenses. He also mentioned that no performance fees, incentive fees or carried interest are projected in this budget as it is extremely difficult to estimate future performance.

Mr. Falzone noted the next section of the budget is Third-Party Service Providers, which includes the projected fees for all of PRIM's advisers, consultants, custodian, audit, tax, legal, risk and investment analytical tools. These fees sum to \$14.9 million or 3.7% of the total budget, about 2 bps.

Mr. Falzone noted the last section of the budget is PRIM's Operations expenses, and includes expenses for PRIM staff compensation and benefits, rent, insurance, office supplies, computers and technology, along with other goods and services necessary to run PRIM. The Operations budgeted fees amount to just over \$14 million or 3.4% of the total budget, or just under 2 bps.

Ms. Coulter discussed the three sections of the budget, highlighting key changes year-over-year. She explained that the Investment Management Fees section is increasing due to asset growth as well as a shift of Public Market Equity assets out of lower fee index accounts into actively managed accounts for U.S. Micro-Cap and Emerging Markets. A new Emerging Manager Direct Hedge Fund program in Portfolio Completion Strategies also contributed to the increase in investment management and third-party service provider fees. She explained that the last section of the budget, Operations Expense, increased mainly due to changes in the Compensation and Benefits section as a result of budgeted new hires and compensation increases based on McLagan's 2017 compensation range review that were approved at the March 6, Compensation Committee Meeting to be recommended to the Board for approval at its next meeting on May 15, 2018.

The Administration and Audit Committee voted (unanimously) to recommend to the PRIM Board that the Board approve the Draft Fiscal Year 2019 PRIM Operating Budget as set forth at **Appendix F** of the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

VI. Results of PRIM Board Self-Evaluation

Mr. Falzone and Robert Brousseau, Chair, introduced Tom Iannucci, President of Cortex Applied Research, Inc. (Cortex), who presented the Committee with the results of the PRIM Board self-evaluation. Mr. Iannucci praised the Board for its commitment and thanked Treasurer Goldberg for her role in achieving three straight years of 100% Board member participation.

Mr. Iannucci noted that the first pages of Cortex's Report of Findings provide a high-level summary of the results, and in general the Board expressed a highly positive view of the performance of the Board, Committees, PRIM management, and staff. Appendix B of the report included a summary list of the recommended actions and it listed two areas that were suggested by Trustees to further enhance the Board's effectiveness.

The first area was Board Education. The report recommended that consideration be given to directing staff to develop and recommend an annual Board Education Plan.

The second area was Planning. Mr. Iannucci listed out the following recommended actions within this area:

1. Continue to develop a proactive approach to succession planning at PRIM to ensure that PRIM will be as well positioned as possible in the event of planned or unexpected staff turnover.
2. Consider extending the length of the annual Board retreat to two days and modifying the agenda to place more emphasis on long-term strategic issues.
3. Consider making greater use of ad hoc Board committees, to deal with longer-term strategic issues as they arise. As discussed in the body of the report, the topic of committee structure and practices will be further discussed during the review of the Board Governance Manual.
4. Consider reviewing the benchmarks being used to evaluate PRIM's staffing and compensation needs to ensure they are consistent with and support PRIM's long-term strategic needs.
5. Consider working with staff to determine how the Board may further engage in the area of operational risk management without encroaching into management's operational responsibilities.
6. Consider an initiative designed to fully define and assess the range of options and perspectives that exist regarding the Board's approach to shareholder activism and environmental, social, and governance (ESG) topics and to arrive at a consensus view that can then be documented in a Board policy or strategy. This issue will likely also be addressed during the review of the Board Governance Manual.

Chair Brousseau and Committee member, Dennis Naughton, both mentioned that their constituents are very interested in ESG and shareholder engagement, and are often approached on this topic.

Mr. Iannucci noted that ESG and shareholder engagement/activism is the one area he identified during the Board self-evaluation where there may be some contrasting views and that additional research was needed. He mentioned several different public pension funds handle ESG and shareholder engagement and shareholder activism differently.

Treasurer Goldberg stated that PRIM's structure is different than many of its peers and PRIM may need to develop its own strategy using the best components used by other public pension funds. Treasurer Goldberg stated that good governance is not only about the social good but is a business imperative and consequently many of the proposals PRIM has made and will make are based on good governance and business imperative.

Several committee members requested clarification on key points of a fiduciary duty presentation provided by John A. Nixon, Esq. from Duane Morris, LLP, at the last Board retreat in September 2017. PRIM staff confirmed they will reach out to Mr. Nixon for additional information regarding his presentation.

Chris Supple, Deputy Executive Director and General Counsel indicated he has been in contact with Attorney Nixon in regard to the Department of Labor Field Assistance Bulletin No. 2018-01, issued last week on April 23, 2018, that states, "shareholder activities that are intended to monitor or influence the management of corporations in which the plan owns stock can be consistent with a fiduciary's obligations under ERISA, if the responsible fiduciary concludes there is a reasonable expectation that such activities are likely to enhance the economic value of the plan's investment in that corporation after taking into account the costs involved".

The consensus of the Administration and Audit Committee was to further examine the recommended actions in Cortex's Report of Findings as part of the Board Governance Policies and Charters review, and the Administration and Audit Committee Chair will discuss the self-evaluation results with the Board at the May Board meeting.

VII. Board Governance Policies and Charters Review

Mr. Falzone noted that Cortex had completed its interviews of Board members for the Board self-evaluation. The consensus of the Administration and Audit Committee was to further examine the recommended actions in Cortex's Report of Findings as part of the Board Governance Policies and Charter review process, inviting all Board members to provide comment on the PRIM Governance Manual both in writing and also in a telephone interview. Cortex will then present the same opportunity to PRIM committee members, and then will present its findings and recommendations at a subsequent meeting of the Administration and Audit Committee. The Administration and Audit Committee also requested that Cortex immediately proceed with a general "cosmetic cleanup" of the existing PRIM Governance Manual.

VIII. Legal/Legislative Update

PRIM's General Counsel informed the Committee that an amendment had been offered in the House budget process that would increase the size of the PRIM Board, and that amendment had subsequently been withdrawn.

IX. Other Matters

The Committee members briefly discussed the following topics:

- a. March 2018 Operating PRIM Budget
- b. Travel

c. Client Service

The PRIM Administration and Audit Committee meeting adjourned at 11:40 a.m.

List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Administration and Audit Committee Meeting of February 1, 2018*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *KPMG Fiscal Year 2018 Audit Plan*
- *Massachusetts State Auditor's Official Audit Report*
- *Draft Fiscal Year 2019 Operating Budget*
- *March 2018 PRIM Operating Budget*
- *Travel*
- *Cortex PRIM Board Self-Evaluation Report of Findings*