Dallas Police and Fire Pension System
Thursday, August 18, 2016
8:30 a.m.
4100 Harry Hines Blvd., Suite 100
Second Floor Board Room
Dallas, TX

Special meeting, Samuel L. Friar, Chairman, presiding:

ROLL CALL

Board Members

Present at 8:30	Samuel L. Friar, Kenneth S. Haben, Joseph P. Schutz, Brian Hass, Tho T. Ho, Gerald D. Brown, Clint Conway, John M. Mays
Present at 8:31	Jennifer S. Gates
Present at 8:46	Scott Griggs
Present at 8:56	Philip Kingston
Absent:	Erik Wilson

Staff Kelly Gottschalk, Josh Mond, Summer Loveland, John Holt, Corina Terrazas, Damion Hervey, Pat McGennis, Ryan Wagner, Milissa Romero, Greg Irlbeck, Carol Huffman

Others Jeff Williams, Michael Egan, Zia Uddin, R. Sean Duff, Rhett Humphreys, Richard Langley, Steven DeGroff, Steve Hollywood, Marcus Dollar, Linda Dollar, Mike Arnold, Doug Mallon, Willie Noel, Tom Caton, James M. Smith, Edwin R. Dresser, Deborah Hughbanks, Keith Caruso, David Beideck, Bill Ingram, Terry Roberts, Steve Carter, Thomas M. Payne, James Elliston, Gary Coleman, Roy Ferguson, Dan Wojcik, Smith Ribble, Edward Davis, Elida Acosta, Will Mixon, Hamp Patterson, William Murrell, Steve Potrykus, Bob Murdock, Tony L. Speck, Michael Tidwell, Bill Warrick, Leftwich Jones, Johnny Bates, Don Smith, Robert Hargrove, James E. Bates, Rowland Tucker, William Everett, Gloria Perez, Richard Perez, Clarrissia Chambers, Carlton Evans, Ray Lemasters, Bill Hornick, Marlin Price, Nathan O. Christopher, Tom Stark, Cindy Stark, Shbrone Mims, Karen Walker, Jeff Walker, Ken Sprecher, David Polls, Stanley Griffis, Eddie Douglas, Frank Ruspoli, Andrew G. Brown, Frankie Joe Losoya, Donald L. Barton, Robert Cummings, Lynn A. Curry, Howard Russell, Frank Varner, Gloria Broadnax, Michael Adamek, Ronnie Bratt, Chris Harry, Thomas Moorman, Luther Moore, Charles Hampton, Donald Robb, Roman Kilgore, David M. Greer, Carl C. Smith, Mary Lavender, Joel Lavender, Michael Yudizky, Nancy Hall, James C. Pearson, Pat Lewter, Greg Courson, Steven Corder, Alan Wammack, Jerry M. Rhodes, Donnie Graham, Ed McFadden, Marshall Cook, Roger D. Hetrick, Wes Johnson, Darrell Dugan, H. C. Stinson, David M. Thomas, Connie Steindorf, Steven Winters, Ray Gonzalez, A. D. Donald, Randy Hooper,

<u>Others</u> (continued) Eddie R. Higgins, Bobby Baughn, David E. Gibson, Brian Johnson, George D. Payne, John Moore, Charles E. Plumlee, Rick Salinas, Clarence Lockett, William E. Phillips, Leon Hullins, Ron Tucker, Dan Smith, Kenneth Cullins, Shelly G. Henderson, Mark E. Tyler, David Smith, Thomas White, Danny Millaway, Napoleon Tucker Jr., Judy Katz, Stuart L. Peterson, Geraldine White, Robert Neuman, W. James Brown, Lingburge Williams, Laura Martin, Murphy Rogers, Rick Brewer, Harold Varner, Richard Duggan, Johnny Rudder, Sallie J. Henderson, David Davis, Beth Sundquist, James R. Moore Jr., Kenneth L. Johnson, Ronnie E. Harris, Richard Ewing, Larry A. Lewis, Harold Symn, Edward Padilla, Antoinette Padilla, David Hill, Glen Bradshaw, Blaine Danyluk, Dwane C. Gidab, Mark Mladenka, Charles E. Gale, Angela Petrovic, Mike Ballance, David Diggs, H. Richard Andrews, Michael Bell, Keith Allen, Carol A. Berry, Jaime Castro, Jerry R. Ramage, Sr., John W. Carr, Doug Jones, Lisa Clayton, Nancy Webb, C. McDonnold, Ron Acker, Elton Garrett, Charles E. Luedeker, Ronnie T. Smith, Arthur P. Richardson, Tracy Landess, Rusty Morgan, Alan Southard, Rick Narramore, Russell Stephens, David Scott Tremain, Jean E. Tremain, Michael Cline, Helen Cline, George R. Scott, David Landry, Lyndon Britt, Danny W. Robinson, Claude Hight, Dennis Wilson, James H. Freeman, Larry Williams, Michael W. Jones, James Baker, Byron Fassett, Judy Richie, Steve Myers, Gregory L. Waddleton, Delridge Williams, Emory Nash, Gregory Dugger, Steve Davis, Roderick Janich, Aaron Anderson, Esteban Maldonado, Jim Aulbaugh, Randy Loboda, Ann T. Robinson, Jason Smith, Charles Hale, Sally D. Lannom, Steve Johnson, Luther J. Smith Jr., Rosemary R. Smith, Sheryl S. Scott, Octavio Saldana, Judith McGee, Diana S. Salinas, Kalon Cohen, Alex Garcia, Joseph M. Dunn, Joseph Allen, Harold Holland, Orlando Robinson, Dominique Artis, Tom Gamez, F.T. Duncan, C.M. Barney, James Parnell, Sherman Evans, Kevin Luper, John D. Wells, Diane Hetrick, Joe Alexander, John W. McKinney, Edward Scott, Byron Titsworth, Mario Valadez, Tristan Hallman, Michael Botsford, Andrea Rega, Tanya Eiserer

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The meeting was called to order at 8:30 a.m.

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A. DISCUSSION AND POSSIBLE ACTION REGARDING ITEMS FOR INDIVIDUAL CONSIDERATION

1. Possible Plan amendments

a. Election Policy and process
b. Discussion of, and possible action on, Plan amendments

a. The Executive Director reviewed the process for conducting an election as required by the Election Policy and the timeframes for a potential plan amendment election.

b. The Long-Term Financial Stability Sub-committee, together with DPFP's actuary, Segal, and staff, presented the Sub-committee's recommendations for possible Plan Amendments on August 11, 2016. The Board continued the discussion of possible Plan amendments.

The Board went into a closed executive session – legal at 8:31 a.m.

The meeting was reopened at 10:22 a.m.

After discussion, Mr. Kingston made a motion to authorize Segal to calculate the effect of a phase-in of member contributions up to 14 percent. Mr. Griggs seconded the motion, which passed by the following vote:

For: Kingston, Griggs, Mays, Friar, Gates, Haben
Against: Brown, Conway, Hass, Ho, Schutz

Mr. Griggs made a motion to make all Plan amendment provisions unconditional except for an increase in the multiplier for members hired after February 28, 2011, and increases in contribution rates for all members over 9%. Mr. Kingston seconded the motion, which was unanimously approved by the Board.

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The meeting was recessed at 11:46 a.m.

The meeting was reconvened at 12:41 p.m.

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1. **Possible Plan amendments** (continued)

   b. Discussion of, and possible action on, Plan amendments (continued)

   The Board went into a closed executive session – legal at 2:08 p.m.

   The meeting was reopened at 2:52 p.m.

   No motion was made.

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2. **Monroe Capital Private Credit Fund II LP**

   As part of the new asset allocation policy and the Private Equity and Private Credit pacing plans, the Board approved a 5% allocation to private credit and $30 million commitment to 2016 vintage year private credit funds. Year to date, DPFP has made a $10 million commitment to Riverstone Credit Partners LP as part of the $30 million commitment. As of June 30, 2016, the actual allocation to private debt strategies is approximately $95 million, or 3.5%, of DPFP's investment portfolio relative to the 5% target.

   Staff recommended that the Board approve a commitment of $10 million to the Monroe Capital Private Credit Fund II LP levered vehicle.

   After discussion, Mr. Griggs made a motion take no action at this time. Ms. Gates seconded the motion, which was passed by the following vote:

   For: Griggs, Gates, Mays, Friar, Schutz, Ho, Conway, Haben, Kingston
   Against: Brown, Hass

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3. **Possible revisions to the Board's Budget Adoption Policy**

   Staff discussed proposed revisions to the Budget Adoption Policy as a result of the termination of the Administrative and Audit Advisory Committee (AAAC) at the May 12, 2016 Board meeting.

   After discussion, Mr. Brown made a motion to approve the Budget Adoption Policy as amended. Mr. Griggs seconded the motion, which was unanimously approved by the Board.

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4. Investment reporting - Maples Fund Services

The Board approved hiring Maples Fund Services in October, 2015 and they were subsequently engaged to provide the Board and staff (i) monthly investment reports, (ii) investment manager transparency reports and (iii) support for ad-hoc reports based on DPFP investment data. James Perry, the former CIO who resigned from DPFP effective July 19, 2016, began working at Maples effective July 26, 2016.

The Board of Trustees and Staff Statement of Ethics, Section J, states:

A Trustee or Employee who leaves the service or employment of the System may not, within twelve (12) months after leaving that service or employment, represent any other person or organization in any formal or informal appearance before the System concerning a project for which the person had responsibility or material involvement as a Trustee or Employee. Moreover, the System will not enter into or renew an existing contract with any entity or any affiliate of any entity during that twelve (12) month period of such Trustee or Employee leaving the service or employment by the System if such entity employs or is represented by the former Trustee or Employee unless the Trustees determine that such a restriction would not be in the System's best interest.

The existing contract with Maples is a month-to-month contract, but the pricing will increase upon the 1-year anniversary as of October 20, 2016. Staff plans to review the current Maples services, as well as performance reporting alternatives, at the Annual Board Workshop in October.

After discussion, Mr. Schutz made a motion to proceed with the planned review of performance reporting services, including Maples Fund Services, at the Workshop in October. Mr. Brown seconded the motion, which was unanimously approved by the Board.

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5. 2016 Board/staff workshop

Staff discussed the workshop plans with the Board.

No motion was made.

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6. Ad hoc committee reports

Reports were given.

No motion was made.

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7. Board Members' reports on meetings, seminars and/or conferences attended

Reports were given on the following meetings. Those who attended are listed.

a. Society of Pension Professionals

Mr. Schutz

b. Wharton: International and Emerging Market Investing

Messrs. Ho, Hass

c. Pension Review Board Meeting

Mr. Schutz, Ms. Gottschalk

d. TEXPERS Basic Trustee Training Class

Messrs. Friar, Haben, Ho, Mays, Brown

e. TEXPERS Summer Educational Forum

Messrs. Friar, Haben, Ho, Conway, Mays, Brown

No motion was made.

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8. Chief Investment Officer position

No discussion was held.

No motion was made.

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The meeting was recessed at 2:53 p.m.

The meeting was reconvened at 2:59 p.m.

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9. Personnel

To discuss the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of public officer or employee: (i) Chief Financial Officer and (ii) General Counsel. Portions of the discussion under this topic may be closed to the public under the terms of Section 551.074 of the Texas Government Code.

The Board went into a closed executive session – personnel at 2:59 p.m.

The meeting was reopened at 3:05 p.m.

No motion was made.

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B. BRIEFING ITEMS

1. Reports and concerns of active members and pensioners of the Dallas Police and Fire Pension System

The Board received comments during the open forum.

No motion was made.

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2. Executive Director's report

a. Future Education and Business Related Travel
b. Future Investment Related Travel
c. Associations' newsletters
- NCPERS Monitor (July 2016)
- NCPERS Monitor (August 2016)
- TEXPERS Outlook (August 2016)
- TEXPERS Pension Observer (Summer 2016)

The Executive Director's report was presented. No motion was made.

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Ms. Gottschalk stated that there was no further business to come before the Board. On a motion by Mr. Brown and a second by Mr. Mays, the meeting was adjourned at 3:05 p.m.

[signature]

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Samuel L. Friar
Chairman

ATTEST:

[signature]

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Kelly Gottschalk
Secretary

AGENDA

Date: August 12, 2016

A special meeting of the Dallas Police and Fire Pension System Board of Trustees will be held at **8:30 a.m. on Thursday, August 18, 2016, in the Second Floor Board Room at 4100 Harry Hines Boulevard, Dallas, Texas.** Items of the following agenda will be presented to the Board:

A. DISCUSSION AND POSSIBLE ACTION REGARDING ITEMS FOR INDIVIDUAL CONSIDERATION:

1. **Possible Plan amendments**

   Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

   a. Election Policy and process
   b. Discussion of, and possible action on, Plan amendments

2. **Monroe Capital Private Credit Fund II LP**

3. **Possible revisions to the Board's Budget Adoption Policy**

4. **Investment reporting - Maples Fund Services**

5. **2016 Board/staff workshop**

6. **Ad hoc committee reports**

7. **Board Members' reports on meetings, seminars and/or conferences attended**

   a. Society of Pension Professionals
   b. Wharton: International and Emerging Market Investing
   c. State Pension Committee Meeting
   d. TEXPERS Basic Trustee Training Class
   e. TEXPERS Summer Educational Forum

8. **Chief Investment Officer position**

   Portions of the discussion under this topic may be closed to the public under the terms of Section 551.074 of the Texas Government Code.

9. **Personnel**

   To discuss the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of public officer or employee: (i) Chief Financial Officer and (ii) General Counsel. Portions of the discussion under this topic may be closed to the public under the terms of Section 551.074 of the Texas Government Code.

B. BRIEFING ITEMS

1. **Reports and concerns of active members and pensioners of the Dallas Police and Fire Pension System**

2. **Executive Director's report**

   a. Future Education and Business Related Travel
   b. Future Investment Related Travel
   c. Associations' newsletters
   - NCPERS Monitor (July 2016)
   - NCPERS Monitor (August 2016)
   - TEXPERS Outlook (August 2016)
   - TEXPERS Pension Observer (Summer 2016)

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #A1

Topic: **Possible Plan amendments**

Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

a. Election Policy and process
b. Discussion of, and possible action on, Plan amendments

Discussion:

a. The Executive Director will review the process for conducting an election as required by the Election Policy and the timeframes for a potential plan amendment election.

b. The Long-Term Financial Stability Sub-committee, together with DPFP's actuary, Segal, and staff, presented the Sub-committee's recommendations for possible Plan Amendments on August 11, 2016. The Board will continue the discussion of possible Plan amendments.

DALLAS POLICE & FIRE PENSION SYSTEM

COMBINED PLAN AMENDMENT ELECTION PROCEDURES

As Amended Through September 9, 1999

DALLAS POLICE AND FIRE PENSION SYSTEM

COMBINED PLAN AMENDMENT ELECTION PROCEDURES

Adopted February 12, 1998
As amended through September 9, 1999

Section 1 Authority to Promulgate Rules

Pursuant to Section 7.01 of the Combined Pension Plan ("Combined Plan"), the Board of Trustees ("Board") of the Dallas Police and Fire Pension System ("System") has the authority to promulgate rules pertaining to the holding of Combined Plan amendment elections.

Section 2 Administrative Responsibilities

The Board of Trustees of the System shall serve as the "Election Judge." The Board may delegate day to day responsibilities for the carrying out of the election to the Administrator and his administrative staff. As Election Judge, the Board of Trustees will supervise any election regarding amendments of the Combined Plan by vote of members on active service. If for any reason the Board of Trustees is unable to perform the duties of the Election Judge, as listed below, then the Administrator or an Assistant Administrator of the System shall serve as the Election Judge. If there is no Administrator or Assistant Administrator able to perform as Election Judge, the legal advisor to the System shall recommend to the Board and the Board shall select a qualified person, who may be another staff person working for the System to serve as the Election Judge.

The System's staff shall:

(1) Place each proposed amendment on the agenda of a special or regular Board meeting for the Board's review and approval or disapproval;

(2) Obtains for the Board a letter from the System's actuary affirming whether each proposed amendment is actuarially sound;

(3) Notify the Police and Fire Departments of the City of Dallas of any pending amendment election called by the Board;

(4) Supervise the posting of notice calling for the election, together with distribution of such supplementary information as the Board deems appropriate to inform members on active service of the scope of each item being considered for approval at such election;

(5) Place the election results on the agenda of a special or regular meeting of the Board to certify the results of the amendment election to the Board;

(6) Contract with a suitable service provider for the electronic casting and tallying of secret ballots by electronic methods.

(7) In the event printed ballots are used instead of (or in addition to electronic voting, as in the case of absentee voting for persons on active military duty), oversee the issuance of ballots to all members on active service, respectively, for deposit in ballot boxes at fire stations and police stations;

(8) Conduct the election at the time designated by the Board;

(9) Assure the integrity of the election process in order to avoid irregularities;

(10) Collect the ballots for counting;

(11) Upon the completion of the election period, report in writing by secure and confidential means the results of the count of ballots to the Board.

(12) Upon the Board's certification pursuant to Section 3(e) below, notify the membership of the System of the results of the amendment election.

Section 3 Details of Amendment Election

(a) Calling the Election

The Board of Trustees shall call an election to amend the Combined Plan not less than three (3) and no more than six (6) weeks before the date the voting is to begin.

(b) Notice of Election

(1) The Administrator or an Assistant Administrator or staff person under their supervision shall send a notice of the amendment election to the Police and Fire Departments, which shall include relevant dates, items to be voted on, and rules.

(2) This notice will be posted at least two (2) weeks prior to the date of election at all police stations, fire stations, City Hall, and all other places where Police Officers, Firefighters, and Fire Inspectors assemble for duty.

(c) **Voting**

(1) Voting on amendments shall be held either by electronic means approved by the Board or by ballot boxes, reasonably accommodating all departmental shifts or watches over at least three (3) consecutive twenty-four (24) hour periods. The Board will set the dates that voting will begin and end. Within said dates, if printed ballots and ballot boxes are used then both the Police and Fire Departments shall set the hours for voting;

(2) The Administrative Advisory Committee of the Board shall have the authority to determine the location of ballot boxes if any are used;

(3) Ballots may be cast electronically or in the event of use of printed ballots and ballot boxes then in the form of those that are manually tabulated or those designed for machine tabulation. If machine tabulation ballots are utilized, copies of the official ballot need to be posted in the voting area;

(4) A complete copy of the amendment(s) being voted upon must be posted at each voting location as well as those locations identified at 3(b)(2) above;

(5) If printed ballots and ballot boxes are used, then each member on active service who votes must sign the voter registration list provided;

(6) If electronic ballots are cast then adequate means of controlling a secret ballot, confirmation of valid ballots cast and the tabulation thereof shall be the obligation of the service entity engaged for such purposes.

(7) Members may only vote once and can only vote by the method, and if applicable at a location, designated;

(8) The Election Judge will receive a written report from any service engaged to receive, tabulate and confirm electronic ballots and if ballot boxes are used will count the ballots and certify the results of the election within forty eight (48) hours of the cessation of voting.

(d) **Election Re-count**

(1) If a member who was eligible to vote desires a re-count of the ballots of an election, the member must file a written request within five (5) days after the results having been certified by the Board have been disseminated to the members. If the margin of difference in the announced vote total being contested is equal to or less than one per-cent (1%), then the recount will be done at the System's expense; however, if the margin is greater than one per cent (1%) then the member requesting a re-count must pay a non-refundable two hundred dollar ($200.00) fee which must accompany the written request for the re-count. This money for the re-count will be placed into the System's Fund;

(2) The Administrator shall supervise the re-count and the Board shall certify the results as provided herein.

(e) **Certification of the Election**

The Board shall certify the results of the election.

Section 4 **Retention of Ballots and Voter Registration Lists**

The ballots and voter registration list, or the electronic records thereof in the case of electronic voting, shall be kept by the Election Judge or the designee for a period of forty-five (45) days after the date the Board certifies the results of an election or longer if required under any records retention policy of the Board. If, after that time, there is no request for a re-count pending, then the ballots and voter registration lists shall be destroyed.

APPROVED on September 9, 1999 by the Board of Trustees of the Dallas Police and Fire Pension System.

Gerald Brown
Chairman

Attested:

A B C D

Richard L. Tettamant
Secretary

DISCUSSION SHEET

ITEM #A2

Topic: **Monroe Capital Private Credit Fund II LP**

Attendees: Michael Egan, Chief Credit Officer
Zia Uddin, Portfolio Manager
R. Sean Duff, Managing Director

Discussion: As part of the new asset allocation policy and the Private Equity and Private Credit pacing plans, the Board approved a 5% allocation to private credit and $30 million commitment to 2016 vintage year private credit funds. Year to date, DPFP has made a $10 million commitment to Riverstone Credit Partners LP as part of the $30 million commitment. As of June 30, 2016, the actual allocation to private debt strategies is approximately $95 million or 3.5% of DPFP's investment portfolio relative to the 5% target.

Monroe Capital Private Credit Fund II LP (the "Fund") is a closed end, senior secured direct lending strategy. The Fund will primarily originate and invest in senior secured loans for lower middle market companies located in North America. The Fund has two choices, an unlevered vehicle with a target net IRR of 8-10% and a levered vehicle targeting net IRR of 12-14%. Staff is recommending the levered vehicle. It is expected that 80-90% of estimated return will come from coupon and loan fees and income will be distributed to investors on a quarterly basis. Monroe Capital LLC, the sponsor of the Fund, was founded in 2004 and is an SEC registered investment advisor. It is one of the leading direct lending platforms with a focus on the lower middle segment of the market. It currently manages approximately $3.3 billion invested and committed assets across multiple vehicles.

DISCUSSION SHEET

ITEM #A2
(continued)

Staff Recommendation: **Approve** a commitment of $10 million to the Monroe Capital Private Credit Fund II LP levered vehicle and **authorize** the Executive Director to negotiate and execute documentation, and perform all necessary acts and exercise all appropriate discretion to facilitate the investment.

DALLAS POLICE & FIRE PENSION SYSTEM

MEMO

Date:	August 18, 2016
To:	DPFP Board
From:	Investment Staff
Subject:	Monroe Capital Private Credit Fund II LP

Recommendation

The investment staff recommends approving an allocation of $10 million to Monroe Capital Private Credit Fund II LP, levered vehicle, within DPFP's private debt allocation.

Executive Summary

At the March 10, 2016 Board Meeting, the Board approved an asset allocation policy that includes a 5% allocation to private debt strategies. At the same meeting, the Board also approved a private markets pacing plan which calls for a total of $30 million allocation to 2016 vintage year private debt funds, as well as a $10 million commitment to Riverstone Credit Partners LP as part of the $30 million allocation to private debt. As of June 30, 2016, actual allocation to private debt strategies is approximately 3.5% relative to the 5% target.

Monroe Capital Credit Fund II LP (the "Fund") is a closed end, senior secured direct lending strategy. The Fund has an unlevered vehicle with a target net IRR of 8-10% and a levered vehicle targeting net IRR of 12-14%. The Fund seeks to provide investors with current income and long term capital appreciation by originating primarily senior secured direct loans for lower middle market companies located in North America. The Fund has a final close on September 30, 2016 and expects to have raised approximately $850 million upon final close. As of July 30, 2016 the Fund has deployed $457 million across 32 loans.

The investment staff recommends an allocation to the Fund based on the following considerations:

The Opportunity

Direct lending is an investment strategy where non-bank lenders provide capital to small and medium-sized companies in the form of loans rather than equity. As the US economy continues to show signs of improvement, demand for financing from middle market companies is increasing. Middle market borrowers need capital to grow their business, as well as to refinance existing loans. However, on the supply side in the after math of the Great Financial Crisis, banks are not only severely curtailed in their ability to lend to middle market companies due to their damaged balance sheets, but also are facing significant regulatory pressure making it increasingly challenging for banks to make loans to middle market companies. As a result, direct lending by alternative asset managers

backed by institutional investors has emerged as a structural replacement for banks. The speed and flexibility offered by non-bank lenders provides a viable and efficient alternative for borrowers conducting business in a competitive landscape. From an institutional investor's perspective, direct lending investments can provide the following benefits to an investment portfolio:

- Steady income yield, as well as long term capital appreciation potential when compared to publicly- traded corporate bonds.
- Portfolio protection from rising interest rates causing lower valuations because the loans are floating rate loans secured by primarily first liens.
- J-curve mitigation by having shorter investment period and current yield when compared to typical private equity investments and certain distress/opportunistic private debt strategies.

Personnel

Monroe Capital LLC was founded in 2004. Monroe Capital Management Advisors, LLC (an affiliate of Monroe Capital LLC), the Fund's investment advisor, is an SEC registered investment advisor. The firm focuses on providing senior and junior debt solutions to lower and middle market companies in the North America. It currently manages approximately $3.3billion committed and managed capital across multiple vehicles including a publicly traded business development company, separate accounts and closed end commingled funds. Since inception, the firm has grown to over 70 professionals including 45 investment professionals. The senior management team comprising of Theodore Koenig, Michael Egan, and Tom Aronson has been working together since 2002 at Hilco Capital and then Monroe since 2004. The firm's investment professionals have backgrounds from various banks and financial institutions such as GE Capital, Capital Source, CIT Group, American National Bank, Van Kampen Asset Management and GMAC finance. It is one of the a few cohesive, dedicated middle market lending platforms that have a history and track record dating back to the early 2000s and have experienced multiple credit cycles. Headquartered in Chicago, Monroe has nine regional offices across the country, as well as relationships with regional banks which allow the team to screen over 2,000 deals annually and allow for selectiveness in making loan investments.

Portfolio and Investment Strategy

The Fund will primarily originate and invest in senior secured loans for middle market companies located in North America. The Fund is allowed to invest in junior and opportunistic private credit opportunities depending on market conditions, but those investments will be limited to 25% of total committed capital. It expects to make 70-80 investments throughout the 4-year investment period of the Fund, with a target weighted average investment size of $20-40 million. It will seek to diversify the portfolio by industry and geography and limit maximum exposure to a single issuer to less than 10% of the total Fund unless it's approved by the investment advisory committee. Historically, Monroe has pursued a 50/50 mix of private equity sponsored deals vs non-sponsored transactions and it is the expectation of this Fund to have a similar split between sponsored and non-sponsored deals. The Fund expects that 80-90% of its estimated return will come from contractual requirements (coupon and fees) and income will be distributed quarterly to investors.

It should be noted that leverage, while enhancing returns can amplify volatility of the Fund, or in a worst case scenario, force liquidation of assets. To mitigate risks associated with leverage Monroe employs a term facility that's not subject to mark to market, and will not leverage its second lien or opportunistic credit positions. Leverage is capped at 2x of committed capital per the PPM but the manager does not anticipate leverage to exceed 1x of committed capital.

	Portfolio Composition	All-in Coupon	Total Net Unlevered Return	Total Net Levered Return
Senior Loans	75-100%	7-10%	8-10%	12-14%
Senior (Direct)	50%+	7-9%	8-10%	12-14%
Unitranche (Direct)	0-40%	8-10%	10-12%	13-15%
Senior Loans (Secondary)	0-15%	7-10%	8-10%	12-14%
Opportunistic Private Credit	0-25%		11%+	13%+
Total Portfolio	**100%**		**8-10%**	**12-14%**

At the core of the Fund's strategy are the following objectives:

- To independently source and originate direct lending loans through Monroe's national sourcing platform.
- To target a consistent and sustainable annual current yield in the range of 12-13% (with leverage) from coupons and loan fees. These loans will be floating rate with a spread over LIBOR.
- To protect capital through conservative underwriting and structuring of loans. Loans are to have low leverage rations, conservative loan-to-value and ample equity support, with amortization and excess cash flow capture. The loans will also have structural protection by being collateralized and will typically have a first lien on all of a borrower's tangible and intangible assets, and pledge of all company stock. Covenants will provide the ability for early intervention in the event of deteriorating financial performance of a borrower.
- To seek predictable exit. The Fund will not rely on event driven or market driven strategies such as M&A or IPO.
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Pricing and Terms

This Fund is organized as a closed end vehicle. Capital will be drawn down over a four year investment period. The Fund intends to make quarterly distributions in the 12-13% range. Life of the fund is six years with two possible one-year extensions. The management fee will equal 1.5% per year on invested capital during and post the investment period. Hurdle rate is 7% for the levered vehicle. The Fund follows the European waterfall, meaning investors of the Fund will receive all capital back and an annualized preferred return of 7% before the general partner can participate in profits. The general partner's carried interest is 20%. Thereafter distributions will be split 80/20

between investors and the general partner. As a NEPC client DPFP will have favorable management fee and carried interest terms relative to the stated pricing. Monroe Capital, as the sponsor of the Fund, will be making a capital commitment to the Fund along with investors of at least 1% of total capital commitments (approximately $8.5 million).

After reviewing the main terms and conditions of the Fund, staff is of the opinion that the terms are market, subject to further review and negotiation by staff and legal counsel.

Fit for DPFP Portfolio

The newly adopted asset allocation policy and private credit pacing plan call for a 5% allocation, as well as $30 million in annual commitments in 2016 to private debt strategies in order to build out the portfolio and maintain vintage year diversification. As of June 30, 2016, actual allocation to private debt strategies is approximately $95 million representing 3.5% of the total portfolio. With the exception of Riverstone ($10 million commitment), the current private debt portfolio is dominated by distressed and opportunistic credit strategies. While distressed and opportunistic strategies are expected to have higher returns with higher risk profiles, senior secured direct lending funds complement those strategies and can add meaningful diversification to the portfolio, in addition to providing vintage year diversification, quarterly income distributions, as well as returns through capital appreciation to DPFP.

Recommendation

Staff sourced this investment with the assistance of NEPC. Staff also independently screened a number of strategies and managers in the private credit landscape to gain market intelligence and consider alternatives in this asset class. The strategies and funds researched include distressed and opportunistic credit/debt, mezzanine debt, senior secured direct lending, international direct lending, asset based lending and special financing. Within the direct lending subcategory, staff with the assistance of NEPC also evaluated a number of direct lending managers that are in the market to raise capital and reached the conclusion to recommend Monroe Capital's senior secured direct lending strategy.

NEPC, LLC

To: Trustees & Staff
Dallas Police & Fire Pension System

From: Rhett Humphreys, CFA, Partner
Keith Stronkowsky, CFA, Sr. Consultant
Jeff Roberts, Sr. Research Consultant – Private Markets

Date: August 18, 2016

Subject: Private Debt Recommendation: Monroe Capital Private Credit Fund II

FUND SUMMARY

Monroe Capital LLC's Monroe Capital Private Credit Fund II LP (Fund or Fund II) seeks to provide investors with current income and long-term capital appreciation by originating senior secured loans in lower-middle market companies located in North America. The Fund will primarily invest in US companies with less than $25 million in EBITDA[1] that require financing to fund a corporate event such as a buyout, refinancing, recapitalization, ownership transfer, or acquisition. Fund II is targeting a portfolio of 25-30 companies at any one time; however, over the four-year investment period, the Fund may invest in a total of 70-80 companies due to capital recycling. The General Partner (GP) is seeking aggregate capital commitments of $850 million for Fund II and is targeting a net internal rate of return (IRR) of 8%-10% (unlevered), or 12%-14% (levered). Please find NEPC's full due diligence write-up below as *Attachment A.*

SUPPORTING THOUGHTS

- Asset Allocation: NEPC's 2016 private markets plan to DPFP includes a $30 million total commitment to private debt. DPFP has already made a $10 million commitment to Riverstone Credit Partners, so the following recommendation is a continuation in the implementation of the recommended plan. As a current policy, DPFP has a 5% asset allocation target to Private Debt, and regular commitments to the area are imperative for proper program management to this target. For reference, please find *Attachment B*, an abbreviated version of the 2016 plan as presented to the Board in March 2016 (*Private Markets Program Review & 2016 Strategic Investment Plan,* March 10, 2016).

- Current Private Debt Portfolio: Currently, DPFP has an investment in Levine Leichtman, which is still actively investing in the corporate loan space, along with some other private debt funds. A commitment to Fund II should help diversify these investments as well as the roster of managers within the private debt program. Specifically, Fund II should serve as a complement to DPFP's recent commitment to Riverstone Credit Partners, an energy-focused fund. Importantly, the Fund is also expected to provide current income back to DPFP, which helps in managing to

[1] "EBITDA" is Earnings Before Interest, Taxes, Depreciation, and Amortization.

liquidity needs.

- Views on the Sector: As a 'value add thesis,' Monroe focuses on lower-middle market companies, which tend to experience a more difficult time accessing capital markets. This structural inefficiency creates an opportunity for lenders to charge a premium. In addition, non-bank lenders have benefited from the constraints on banks and other sources of capital as a result of the credit crisis.

- Fund Level: Monroe has a long-term track record in the senior lending space, dating back to 2002. The Firm has had a low loss rate and has delivered on expected returns throughout multiple cycles. The GP is expected to leverage the Monroe platform that has been constructed to evaluate sponsored and non-sponsored opportunities. The firm has invested deeply in developing sourcing capabilities across the US, allowing the team to see approximately 2,000 deals per year, screening for 70-80 investments. Please find NEPC's full due diligence write-up below as *Attachment A*.

CONCLUSION / RECOMMENDATION

NEPC recommends that DPFP commit $10 million to Monroe Capital Private Credit Fund II (levered vehicle). A commitment here would be in line with the 2016 plan approved by the Trustees on March 10, 2016 (attached) and would serve as a compliment to the current Private Debt program. This fund has also been given a "Preferred" rating by NEPC.

NEPC, LLC

YOU DEMAND MORE. So do we.SM

Attachment A

NEPC Private Markets Investment Due Diligence Research Report

Monroe Capital Private Credit Fund II LP

Monroe Capital LLC

Report written by NEPC Research as of March 23, 2015.

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Executive Summary

Monroe Capital LLC's (the "Firm" or "Monroe") Monroe Capital Private Credit Fund II LP (the "Fund," "Fund II," or "Monroe II") seeks to provide investors with current income and long-term capital appreciation by originating senior secured loans in lower-middle market companies located in North America. The Fund will primarily invest in US companies with less than $25 million in EBITDA that require financing to fund a corporate event such as a buyout, refinancing, recapitalization, ownership transfer, or acquisition. Fund II is targeting a portfolio of 25-30 companies over a four-year investment period.

The General Partner ("GP") is seeking aggregate capital commitments of $600 million for Fund II. The Fund is targeting a net internal rate of return, or IRR, of 8%-10% (unlevered), and 12%-14% (levered).

Positives:

- ***Organization:*** The senior members of Monroe are a highly experienced, cohesive team, operating together at Hilco and Monroe Capital. The organization has also added members from GE Capital, Capital Source, CIT Group, American National Bank, Van Kampen Asset Management, and GMAC Finance. The Firm has consistently demonstrated its abilities in origination, underwriting and workouts when necessary.

- ***Track record:*** Monroe has a long-term track record in the senior lending space at Hilco and Monroe Capital that dates back to 2002. The Firm has had a low loss rate and has delivered on expected returns throughout multiple cycles.

- ***Deal sourcing:*** The Fund will leverage the Monroe platform that has been constructed to evaluate sponsored and non-sponsored opportunities. Monroe has invested a large amount of resources in developing sourcing capabilities across the US; this allows the team to see approximately 2,000 deals per year and screen for around 25-30 potential investments.

- ***Lower-middle market focus:*** Lower-middle market companies have a harder time accessing capital markets, creating an opportunity for lenders to charge premium pricing. In addition, non-bank lenders have benefited from the constraints on banks and other sources of capital as a result of the credit crisis.

- **Diversification:** The senior Fund is expected to be diversified by type of industry and is expected to invest in 25-30 loans (not including recycling).

Negatives:

- ***Conflicts of interest:*** The Fund may be forced to forgo or receive a reduced allocation to a loan depending on the availability of the investment and the various Monroe vehicles. Monroe has attempted to mitigate confusion through its allocation policy.

- ***Increased fund size:*** The Fund target size will be approximately 50% larger than Fund I. It may take longer to fully deploy capital relative to Fund I.

- ***Longer investment period/ fund term:*** The investment period has increased by one year relative to Fund I. The Fund term has also increased by a year compared to Fund I.

- ***Lowered preferred return:*** The unlevered Fund will have a lower preferred return than its predecessor. Fund II will have a 5% preferred return as opposed to 7% for Fund I. The levered vehicle will have the same preferred return.

- ***Shared fund resources:*** In addition to the day-to-day responsibilities of managing the Fund, senior professionals may be involved in activities on behalf of Monroe Capital that do not directly or indirectly provide any benefit to the Fund.

- ***Leverage:*** For investors seeking to amplify Fund-level returns with leverage, the strategy may amplify volatility of the Fund or, in a worst case scenario, force liquidation of assets.

Fund Characteristics

Investment Vehicle	Delaware limited partnership (onshore)/ Cayman Island limited partnership (offshore)
Investment Manager	Monroe Capital Private Credit Fund II LP
Target Size/Max Size	$600 million/ $750 million
Amount Raised	$660 million; the Fund had a first close on 5/15/15
Minimum Investment Size	$5 million (negotiable)
Target Final Close Date	9/30/2016
Investment Period	Four years from final close
Fund Term	Six years from initial close; plus two one-year extensions
Sponsor's Investment	1% of target fund size (approximately $6 million)
Assets Under Management	Approximately $3.3 billion as of July 1, 2016
Investment Focus	Direct lending strategy providing first-lien senior structures
Geographic Focus	North America
Projected Number of Investments	25-30
Deal Size	Transaction sizes will range from $14 million to $80 million (average transaction size of $32 million)
Target Fund Return	8%-10% IRR (unlevered); 12%-14% IRR (levered)
Leverage	Option to invest in levered or unlevered Fund; the levered vehicle expects to run leverage at 1:1 with a cap of 2:1
Annual Management Fee	1.00% on invested capital during and post-investment period;
Other Fees	The Fund will pay expenses not reimbursed by portfolio companies, ongoing monitoring expenses and fund administration expenses
Organizational Costs	Up to $1.5 million
Carried Interest	10%
Preferred Return	5% (unlevered) 7% (levered)
Distribution Waterfall	At the Fund level: • First, 100% to Limited Partners ("LP") until cumulative distributions equal cumulative capital contributions; • Then, 100% to Limited Partners until they receive an 5% (unlevered) or 7% (levered) annual rate of return on their capital contributions on each realized investment; • Thereafter, 90%/10% LP/General Partner ("GP") split
ERISA Fiduciary	The onshore component is expected to limit ERISA investors to 25%. Therefore, the Fund is not intended to be managed as a plan asset fund under the Employee Retirement Income Security Act of 1974; Monroe is not intending for the Fund to operate under the fiduciary obligations required of plan asset fund managers.
Key Person(s)	Theodore Koenig, Michael Egan and Thomas Aronson
Fund Auditor	Grant Thornton LLP
Fund Legal Counsel	Purrington Moody Weil LLP
Placement Agent(s)	None
Website	www.monroecap.com

Firm Description

Firm Overview

Monroe Capital was formed in 2004 by three former Hilco executives, Ted Koenig, Mike Egan and Tom Aronson. Monroe focuses on lending to middle- and lower-middle market companies primarily located in the United States. The Firm's professionals have backgrounds from various financial institutions, including GE Capital, Capital Source, CIT Group, American National Bank, Van Kampen Asset Management and GMAC Finance. In addition to its investment staff, the Firm has a fully-integrated accounting/ finance group, operations, back-office, and investor relations staff located at Monroe's headquarters in Chicago. The Firm has additional offices in Atlanta, Boston, Charlotte, Los Angeles, Dallas, San Francisco and New York City for the purpose of originating transactions.

The Firm currently has over 48 individuals on staff, including 34 who devote a material amount of time to the Fund (employees who dedicate >50% of their time to the Fund). Monroe has invested approximately $2.5 billion in over 500 middle-market lending transactions across closed-end funds, managed accounts and a business development company. The Firm has five other current funds: Monroe Capital Senior Secured Direct Loan Fund LP (90% invested), Monroe Capital Partners Fund, L.P. (90% invested), Monroe Capital Partners Fund II LP (SBIC), publicly-listed Monroe Capital Corporation (ticker: MRCC), and Monroe FCM Direct Loan Fund LP. The investment objectives and parameters of each program vary and each program is governed by its own respective operating documents which may have different investment terms and conditions.

Monroe is an independent, 100% employee-owned investment manager. The daily activities of the Firm are overseen by Ted Koenig, who serves as the President and CEO, and Michael Egan, Chief Credit Officer, Thomas Aronson, Head of Originations, and Jeremy VanDerMeid, Portfolio Manager (the four "Partners"). The Firm has five owners, including the four Partners and one senior underwriter. As of December 31, 2014, Monroe had approximate $1.9 billion of total assets under management.

Team Overview

The Firm has 34 investment professionals dedicated to Fund II. Excluding the four partners dedicated to the Fund, the remaining 30 investment professionals consist of the origination team (12 members) and underwriting and portfolio management team (18 members).

Recent Turnover

The Monroe team has experienced 10 departures of investment professionals at the vice-president level and above over the past five years. The departures consisted of six managing directors, one senior vice president, one senior president and two directors. The average tenure of the 10 departed employees was 1.6 years. Of the managing directors, three left to join banks (Ally Bank, TCF Bank and Goldman Sachs), two left to start their own company, and one left to pursue an unspecified opportunity. The senior vice-president left to join Opus Bank, the vice-president left to join Prudential Capital Group. Of the two directors who left, one joined Golub Capital and the other started his/ her own company.

Succession Planning

Monroe is staffed with 34 investment professionals at different levels in their careers. The Firm has four Partners, each able to handle a majority of the tasks required to manage the Fund. This helps to mitigate the risks associated with any one or more individuals leaving the Firm. It is anticipated that all of the Partners and senior team members will own an equity interest in the Fund and have provisions in place to help incentivize them to perform. In the event of a succession occurrence with respect to any Partners, there is a plan in place to acquire and re-allocate the principals' GP interests. Mr. Koenig is the Managing Member of the GP and the Chairman of the Investment Committee. In the event that Mr. Koenig shall die or become disabled, then the remaining members, by majority vote, shall elect a successor Managing Member and Chairman of the Investment Committee. The newly elected Managing Member of GP will be able to step into that role with minimal disruption to the internal working of business. Since most of the members and the management team have worked together for 10 years, there will be minimal, if any, disruption to the business of the Fund should something happen to Mr. Koenig. Another aspect of the plan is 100% of the ownership interest is distributed among the employees, with no member owning a majority of the GP. The broadly dispersed ownership by each

member further aligns the interests of all of the members of the GP with the interests of the Limited Partners.

Fund Investment Strategy

Investment Strategy

The Fund will directly originate senior secured direct loans in middle-market companies primarily located in the United States. The Fund will leverage Monroe Capital's sourcing and underwriting platform that has been operating since 2004. It aims to protect invested capital and generate high-single digit to low-teen net IRRs by focusing on the senior position in the capital structure and accessing transactions that require a heavy origination effort. Monroe expects the following debt/ equity concentration in the portfolio:

Security Type	***Percentage of Invested Capital***
Senior Secured – 1st Lien	50%+
Unitranche	0-40%
Opportunistic Private Credit	0-25%
Equity Upside (Warrants)	5%
Debt/ Equity	**95%/100%/0-5%**

The Fund will target senior secured direct lending investments in a wide range of industries. The Fund will also seek diversity in terms of investment size, company type, industry, geography and asset type. The Fund is targeting investments in middle-market companies with EBITDA of $3 million-$25 million and revenues of $25 million-$250 million. Monroe is staffed to pursue deals alongside private equity sponsors and non-sponsored transactions. Historically, the Firm has pursued a 50%/50% mix in sponsored and non-sponsored transactions. The Fund will seek companies with stable and consistent cash flow generation and will not engage in distressed transactions with companies that have negative earnings. The Fund's strategy is designed to provide Limited Partners with access to a transparent and diversified portfolio of otherwise hard to access, secured private loans. The following are core elements of the Fund's strategy:

- Strong current income: The Fund's investments will target a consistent and sustainable current income distribution of 7%-10%.

- Protection of capital: The Fund's focus will be on the safety and protection of invested capital. Loans will be well-collateralized and, typically, will have a lien on a borrower's tangible and intangible assets and a pledge of company stock. Covenants will be structured to provide the ability for early intervention in the event of deteriorating financial performance of a borrower.

- Conservative structure: Loans are expected to have low leverage ratios, conservative loan-to-value ratios and significant equity capital support and a repayment schedule based on a conservative estimate of the borrowers' predictable free cash-flow generation capability.

- Agented by Monroe: The Fund is targeting ~75% of transactions to be agented by Monroe. This increases return and reduces the risk for each investment. As Agent, the Fund will receive optimal interest and fees. Additionally, the Fund will be in the position to structure covenants and protect its capital.

- Predictable exits: In addition to the Fund's conservative approach to structuring and emphasis on protection of capital, the Fund will seek a predictable exit. The Fund's investments are not expected to be dependent on event-driven or purely market-driven exit strategies, such as robust merger and acquisition markets or a fully functioning IPO market.

- Return enhancement: Additional yield generation will come through pay-in-kind, or PIK interest, warrants and success fees. The Fund is targeting total gross investment returns of 12%-14% per annum.

- Portfolio diversification: A broad array of industries will be targeted to produce a balanced and relatively non-correlated portfolio of investments. The portfolio will be structured to have the downside protection inherent in a collateralized pool of assets.

Target Fund Return
Fund II is targeting an 8%-10% IRR for the unlevered vehicle and 12%-14% for the levered vehicle. The target returns are net of manager fees.

Target Fund Size
Fund II will have a $600 million target fund size and a $750 million hard cap. The Fund's target size is 50% larger than the predecessor fund, which raised $400 million.

Target Investment Types
The Fund will invest in credit facilities provided to lower-middle market companies, including first-lien and unitranche secured loans. Additionally, the Fund will receive a small portion of equity in the form of "put warrants" to ensure alignment with the duration of the Fund.

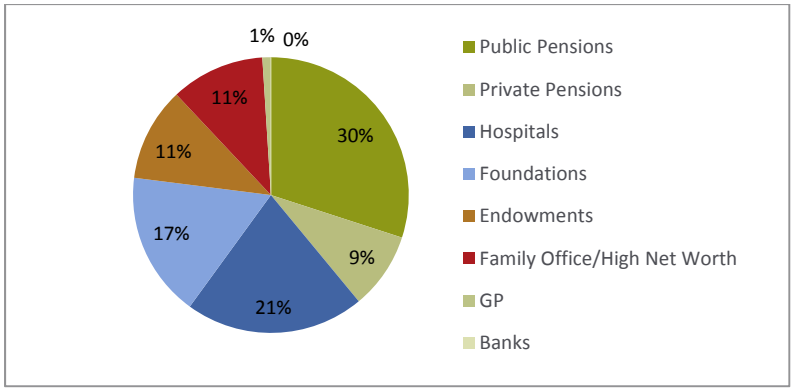
Target Geographic Focus
The Fund will invest in companies based in North America.

Target Deal Size
The Fund will make investments of between $14 million to $80 million with an average transaction size of approximately $32 million.

Use of Leverage
At the investment level and in the levered vehicle, target leverage is approximately 60%-70%. The Fund will not have a limit of leverage on any individual position. At the fund level, the target will be between 60%-75% with a fund level cap at 100%. The Fund intends to, but does not currently have, a subscription line of credit.

Recycling of Capital
The Fund will recycle the principal received during the four-year investment period. All interest, fees, gains from warrants/ success fees/ equity will be distributed on a quarterly investment during and after the investment period. All principal will be recycled during the investment period and distributed after the investment period of the Fund.

Expected Fund Investor Base
The expected investor types in Fund II include state and local pension plans, corporate pension plans, university endowments, not-for-profit foundations, hospitals and family offices. As a proxy for Fund II, the Monroe Capital Secured Senior Secured Direct Loan Fund LP investor base by type is listed below:



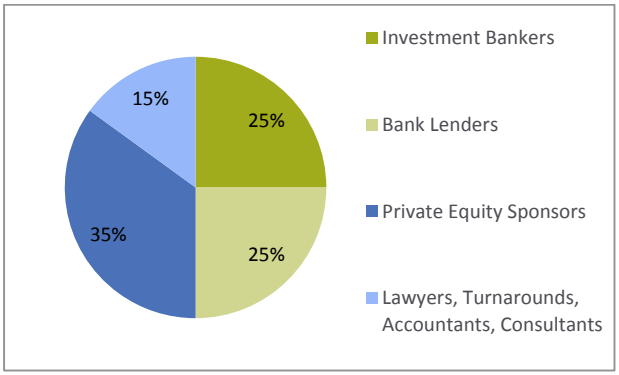
Current Fund Investments

The Fund has currently not made any investments.

Fund Investment Process

Deal Sourcing

Monroe has a national, regional and local network of industry relationships formed throughout the past decades. Monroe's senior investment professionals individually average over 16 years of middle-market investing experience and have developed a broad and robust referral network of over 10,000 private equity firms, consultants, turnaround professionals, lenders, investment bankers, CFOs and individuals, resulting in over 2,000 investment referrals per year. Monroe maintains direct origination capabilities in Chicago, Atlanta, Boston, Charlotte, Dallas, Los Angeles, San Francisco and New York City. The origination platform consists of 13 dedicated senior professionals. The following chart illustrates Monroe's diversity of referral sources.



Historically, Monroe has found that regional and local financial institutions have been a strong source of private loan deal flow. Monroe will attend local trade meetings and regional conferences to maintain and create long-term institutional relationships. Monroe has 15 strategic banking partners, including seven who are limited partners in funds managed by Monroe and 15 who are credit providers to various Monroe funds. There is a strong incentive for deal flow from these bank referral sources due to the benefits they receive from not only being a limited partner or lender to Monroe, but also participating in the working capital asset-based revolving loan facility or first-out piece in the loans that are originated by Monroe. In addition, Monroe provides all deposit and operating accounts of its borrowers to its strategic bank partners. The strategy is created to not be dependent on private equity firms in order to execute investment transactions. Historically, there has been a 50/50 split between private equity sponsored and non-sponsored loan transactions.

Investment Process

As investment opportunities are identified initially through the Origination team, led by Tom Aronson, they are logged into a deal log. Often times, the material is presented in the form of a third-party offering or financing memorandum. Generally, all of the Investment Committee and other support staff will review the material in advance of the deal review meeting. At the meeting, all of the active investment opportunities are discussed and then each is reclassified in the log based upon the deal's status, ranging from an initial review stage to closed or no longer pursuing. Any member of the Transaction Execution team, led by Mike Egan, Jeremy VanDerMeid, Zia Uddin and Alex Franky, can take the initiative to recommend pre-screening of a transaction; these professionals are supported by a staff of underwriters. Typically the information for pre-screening is derived from an internal memorandum or from company information. The team will generally prescreen companies on the following traits: strong cash-flow generation, stable earnings, defensible market positions, recurring revenues, low cyclicality, strong importance to customers and minimal technology risk.

After a favorable screening review, a due diligence team assigned to the transaction will conduct initial meetings, preferably an on-site, with the respective companies. There will be one or two Investment Committee member(s) present at all on-site visits. The formal due diligence process requires the following: quality of earnings analysis, market study/ business review, valuation, financial modeling/ sensitivity analysis, customer calls, background checks, multiple manager meetings, appraisals/ field

exam, insurance/ pension review, environmental reports and legal review. Within the listed analyses, general imperative credit worthiness factors are included (see below). Many of these are included in the pre-screening process as well.

- Limited customer concentration/ diversified customer base
- Cyclicality of industry/ business
- Valuation in downside scenario
- Recurring revenue (contractually based)
- High barriers to entry
- Reasons to exist/ defensible market position
- Importance to customers
- Stable cash flows
- Minimal execution risk (buyout or acquisition)
- Minimal motivation risk (dividend recapitalization)
- Minimal technology risk
- Proven management team

If the initial meetings and due diligence calls are positive, the next step will generally be to express to the sponsors, company management or their agents a willingness to issue a preliminary term sheet. Issuing a term sheet will take place after appropriate review and approval by a member of the Investment Committee. Any term sheet is highly conditional and subject to acceptable due diligence, investment committee approval and legal documentation. Nonetheless, the Fund will issue term sheets with the expectation that they will not be withdrawn unless something unforeseen is discovered or occurs during the due diligence process. Assuming the terms are acceptable and a signed preliminary term sheet agreement is agreed upon, the team can commence formal due diligence. The term sheet phase is an interactive negotiating process that typically takes three to four weeks. The Fund will seek to structure transactions with the following traits:

- 5%-20% contractual amortization
- 50%-75% excess cash flow recapture
- Senior debt positions (no mezzanine transactions)
- Generally 3.0x-4.5x TTM EBITDA
- 50%-60% loan-to-value

Upon completion of all due-diligence, the Fund will complete an extensive analysis of the company, including company background, market information, management reviews, financial analysis, enterprise valuation and exit strategy analysis. The Investment Committee must approve an investment in order to proceed. It is unusual for an investment at the Investment Committee to be turned down as its members work together daily and are kept apprised of the ongoing due-diligence process and any issues that develop are addressed immediately. Investment Committee members are given the opportunity to fully understand all investment risks and review the proposed structure based on all the available due diligence.

After approval from the Investment Committee is received, a commitment letter is prepared for the transaction. At this time, typically, a commitment fee is required in addition to any additional deposit to cover the costs of documentation. Upon receipt of the executed commitment letter and additional fees, the Fund will commence loan documentation. Final loan documents will be reviewed by the Investment Committee prior to execution. Nearly 100% of the transactions in documentation proceed to closing.

Value Creation

The investment objective of the Fund is to generate attractive risk-adjusted returns on invested capital by acquiring, directly or through Fund subsidiaries, portions of credit facilities to middle-market companies, including first-lien and second-lien secured loans. Investment opportunities will be presented to the Fund by Monroe's middle-market sourcing platform. Monroe will have approximate 50% private equity sponsored and 50% non-private equity sponsored transactions. The Fund is

expected to receive certain proceeds from fund assets, including interest, certain fees, principal repayment, sale or liquidation proceeds. Generally, the exit strategy for the Fund consists primarily of repayment of the assets during the term of the Fund.

Risk Mitigation

Each of Monroe's individual deals has its own specific credit and performance risks. One of the fundamental ways Monroe mitigates this risk is through a wide origination funnel; having plenty of deal opportunities is a protection against adverse selection. This is further reinforced by the organizational structure and key areas of focus, robust and proprietary (non-auction) transaction flow driven by a large origination staff that is not focused on a core group of private equity sponsors. Risk is further mitigated by extensive due diligence, careful structuring of each loan and close monitoring of each asset. Financial covenants are built into every loan and are never covenant-lite.

The core of the investment philosophy is "credit first, zero loss." Over the past 12 years, the Firm has a historical cumulative loss ratio of 0.33% (loss of $5.7 million in four transactions) on the $1.8 billion invested. Heavy due diligence is performed in order to understand all risks present in a given transaction. Downside financial models are created to determine the appropriate structuring and ensure that transactions are levered at an acceptable level (as a multiple of EBITDA), are de-levering at an acceptable level (sufficient amortization and excess cash flow), and have proper covenants and legal documentation in place. Principal protection, or a zero-loss tolerance, is a key goal of the due diligence and structuring process. Monroe's loans typically have a loan-to-value of less than 60% and leverage multiples of less than 4.0x. In addition, loans are typically the only debt component to the company's capital structure. Risk is further mitigated through investment restrictions such as maximum position sizes being capped at 10%, 20% limitation by industry, leverage cap of 2.0x and investments located solely in North America.

Finally, customized and rigorous monitoring is performed to track risks uncovered during due diligence. In essence, the goal is to understand the key drivers of the business along with the risks and craft a structure that not only realizes the most significant financial upside for investors, but also mitigates the risks of the transaction significantly. Early intervention and active monitoring is the most important tool that Monroe uses on its credit investments. Monthly discussions with management teams as well as monthly "trend cards" are developed to monitor the financial performance of the company. Monroe professionals are in contact with management/ the sponsor generally one to two times per month. As needed, contact with management/ sponsor may be as much as weekly or even daily. It is essential to note that in addition to contractually mandated financial data and covenants (monthly or quarterly), proprietary trend card information is gathered on daily, weekly, or monthly basis across a variety of qualitative and quantitative factors (for instance, accounts receivable and customer retention).

Allocation Policy

The General Partner expects to conduct the Fund's investment program in a manner similar to its (or its affiliates') existing and future investment funds and other managed accounts with similar investment objectives and strategies. The existence of multiple clients creates a number of potential conflicts of interest. During the Investment Period, the General Partner agrees that it shall present all investment opportunities to the Fund, provided that (i) such investment opportunities, in the good faith judgment of the General Partner, meet the Fund's investment criteria and are available to the Fund, and (ii) the Fund is otherwise able to make such investment. In cases where a limited amount of a security or other instrument or claim is available for purchase, the allocation of such security, instrument or claim among the Fund and such other funds or accounts may necessarily reduce the amount thereof available for purchase by the Fund.

Subject to the above limitations, when it is determined by the General Partner that it would be appropriate for the Fund and one or more Other Clients (defined below) to participate in an investment opportunity, the General Partner will generally allocate such investment opportunity among the Fund and such Other Clients in proportion to the relative amounts of capital available for new investments, taking into account such other factors as it may, in its sole discretion determine appropriate, including relative exposure to market trends, targeted leverage level, targeted asset mix, diversification requirements, strategic objectives, specific liquidity requirements and the investment programs and

portfolio positions of the Fund and the Other Clients for which participation is appropriate, as well as any tax, legal, regulatory or other considerations that it deems necessary or appropriate in light of the circumstances at such time.

In any case where the Fund and one or more Other Clients invest in the same investment opportunity, such investment shall be made at the same time and on the same terms and conditions at the investment level, except as may be required for tax, regulatory or legal restrictions or other considerations. Under no circumstance will the General Partner cause or permit the Fund or any Other Client to invest in different tranches or series of loans or securities issued by the same borrower, unless such participation is pro rata by the Fund and such other Client(s) across both tranches or series so that there is no conflict. Furthermore, when it is determined by the General Partner that it would be appropriate (whether pursuant to a previously agreed upon arrangement or otherwise) for a third party to participate in an investment opportunity in which the Fund and/ or the Other Clients will participate, the General Partner will use its best business judgment and act in a manner that it considers fair and reasonable in seeking to allocate such investment opportunity on an equitable basis, taking into account any such considerations that it deems necessary or appropriate in light of the circumstances at such time.

Fund Economics

Management Fee

NEPC has negotiated fee breaks on behalf of its clients. The partnership will pay management fees to the General Partner in the following structure:

Through the end of the Investment Period:

- 1.00% of invested capital per annum (payable quarterly in advance)

After the Investment Period:

- 1.00% of invested capital

Distribution Waterfall

The return of capital, the hurdle rate and the carry are based on the performance at the Fund level. The priority of distributions follows:

1. First, 100% to Limited Partners until cumulative distributions equal cumulative capital contributions on all realized and unrealized investments;

2. Then, 100% to Limited Partners until they receive a 5% (unlevered vehicle) or 7% (levered vehicle) annual rate of return on their capital contributions;

3. Followed by 90% to Limited Partners and 10% to the General Partner

Allocation of Carried Interest

The carried interest is spread across all levels of the investment professionals and evenly to senior members as follows:

Name/Group	*Percentage of Carried Interest*
Ted Koenig, Michael Egan, Thomas Aronson, Jeremy VanDerMeid	60%-75%
Other Employees	10%-20%
Reserved	5%-10%
Total	**100%**

Other Fees and Expenses

The Management Company shall pay, and the Partnership will not be obligated to pay, the following expenses related to Partnership activities: salaries, bonuses and fringe benefits of professional, administrative, clerical, bookkeeping, secretarial and other personnel employed by the Management Company; rent, office equipment, fire and theft insurance, heat, light, cleaning, power, water and other utilities of any office space maintained by the General Partner on its own behalf or on behalf of the Partnership; stationery, postage, office supplies for the General Partner and the Partnership; in-house bookkeeping services; secretarial services; travel and entertainment (to the extent not Transaction Expenses); telephone (local and long distance); data processing; and any other overhead type of expenses.

Fund Administration, Structure and Policies

Fund Structure
Monroe II's onshore vehicle is a Delaware limited partnership. Investors in the offshore fund will hold their interests indirectly a Cayman Islands exempted limited partnership, which will elect to be treated as a corporation for purposes of US federal income taxes.

ERISA Provisions
The onshore fund is expected to limit ERISA investors to 25%.

UBTI Considerations
Unrelated business taxable income, or UBTI is generated by the Fund through the origination fees, but is minimized through the offset of the management fee.

Labor Policy
The Firm does not have a labor policy.

Key Person Provision
If any two of Theodore Koenig, Thomas Aronson and Michael Egan (each, a "Key Person") cease, for any reason, to be actively involved in the day-to-day management of the General Partner (a "Key Person Event"), the General Partner will immediately notify the Limited Partners and the Limited Partner Advisory Committee of the occurrence of such Key Person Event and shall discuss with the Limited Partner Advisory Committee and/ or the Limited Partners a course of action for the continued operations of the Partnership in light of the Key Person Event (which may include the substitution of replacements for such specified Person). If the Limited Partner Advisory Committee does not approve any such course of action within 45 days following the notice of the Key Person Event, the Investment Period shall terminate 60 days following the occurrence of such Key Person Event. If the Limited Partner Advisory Committee approves the course of action proposed by the General Partner, notwithstanding such approval, a Majority-in-Interest of Fund Investors may terminate the Investment Period by written notice given within 60 days following notice to the Limited Partners of the course of action for the continued operation of the Partnership.

GP Removal Provisions
The General Partner may be removed from the Partnership and replaced with the written consent of Limited Partners holding at least 66-2/3%-in-Interest of the Fund Investors only for Cause (defined below) by delivery of written notice to the General Partner no later than 90 days following delivery to the Limited Partners (and investors in any Parallel Fund) of written notice stating that an event constituting Cause has occurred, which the General Partner shall deliver promptly following the occurrence of any event constituting Cause. "Cause" means that the General Partner, the Management Company or any Key Person has (i) been convicted of, or entered a plea of no contest with respect to, a felony involving a material violation of United States Federal securities laws or the misappropriation of funds, or (ii) has been determined in any final, non-appealable judgment entered by a court of competent jurisdiction to have committed acts or omissions that constitute fraud, gross negligence or willful misconduct in carrying out the duties of the General Partner or the Management Company; provided, that (x) in the case of gross negligence, such acts or omissions have a material adverse effect on the Partnership, and (y) if the employment of the person involved in the event constituting Cause is terminated, such event shall not constitute Cause; and provided, further, that a loss in connection with any Investment of the Partnership will not, by itself, constitute fraud, gross negligence or willful misconduct.

LP Advisory Committee
The Fund will establish a Limited Partner Advisory Committee ("LPAC") composed of Limited Partners selected by the General Partner. The LPAC will comprise at least one limited partner of significant size from each fund (onshore leveraged, onshore unleveraged and offshore). The LPAC will meet twice annually and review conflict of interests, third-party valuations, and also examine buy, sell or transfers to other Monroe Capital funds.

Reporting
Quarterly financials and quarterly updates will be distributed, outlining the investments made in the fund.

Valuation Policy
Valuations will be done by a third party on a quarterly basis.

Litigation, Regulation and Compliance

Current Litigation
In late 2010, as part of a strategy by Monroe Capital, LLC to collect on its indebtedness from one of its' portfolio companies, Butler Services, Monroe Capital, LLC, through a trustee appointed by the bankruptcy court, filed a collection proceeding against Butler Services in Florida. The Borrower, Butler Services, filed a counter claim against Monroe Capital, LLC and its Chief Credit Officer (Michael Egan), and a co-lender in the transaction, along with its Chief Credit Officer. The lawsuit is currently being adjudicated and Monroe Capital, LLC believes it will prevail on its damages and collection. The counterclaim against Monroe Capital, LLC and its Chief Credit Officer (Michael Egan) is without merit and should be dismissed accordingly.

Past Material Litigation
1. In early 2008, Morgan Stanley Asset Management ("MSAM") disputed a trade it contended it made with an employee of Monroe Capital, LLC regarding a collateralized loan obligation, or CLO asset. MSAM filed a claim against Monroe Capital, LLC in New York City seeking to require the CLO to purchase a loan position of MSAM. Monroe Capital, LLC did not believe the claim had merit and responded accordingly to MSAM. The attorneys for both sides negotiated a settlement of this claim with MSAM. The matter was resolved and dismissed.

2. In 2014, an affiliate of the General Partner brought a lawsuit against an employee for a violation of company policies with respect to confidentiality of company information and trade secrets. That lawsuit has been successfully resolved, settled and the suit dismissed.

Compliance Staff and Philosophy
The Firm has a compliance manual in process and has two individuals, David Jacobson and James Cassady, dedicated to this function. Monroe also employs a third party, Blue River Partners, to ensure compliance monitoring occurs.

SEC Oversight
Monroe is registered with the US Securities and Exchange Commission (SEC) as an investment adviser under the Investment Advisers Act of 1940. The entity name is Monroe Capital Management Advisors LLC. The Firm's last audit by the SEC was in 2013 and there was nothing materially noted.

Subject to Other Regulators
The Firm is regulated by the SEC and the US Small Business Administration with respect to the SBIC funds that are managed in addition to being governed by the SEC with respect to its publicly-listed business development company (MRCC).

Personal Trading Restrictions
The Firm manages a restricted trading list and its third-party compliance firm, Blue River Partners, checks this on a quarterly basis through submitted brokerage statements automatically.

Firm Infrastructure

Office Locations
The Firm's senior investment professionals reside in the Chicago headquarters. The back-office, marketing, underwriting and compliance staff is also based in the Chicago office. Other offices throughout the United States are origination offices and include the following: Atlanta, Boston, Charlotte, Dallas, Los Angeles, New York and San Francisco.

Technology Resources and Systems
Wall Street Office Agent, Web and Administration Software, used for
- Bank deal management
- Activity management
- Cash management
- Lender and issuer notifications
- Trade entry
- Transaction processing
- Portfolio reconciliation

Wall Street Office Compliance Software, used for
- Custom server module
- Automated compliance or covenant testing required by the governing bond indenture

Clearpar, used for
- Web-based trade settlement portal
- Trade cash reconciliation

iLevel, used for
- Portfolio management
- Investor relations
- Track record

Business Continuity Planning
Disruption of Business/ Disaster Plan of Action. In the event of an extended power failure, emergency situation or disaster that prevents access to Monroe Capital's corporate offices located at 311 South Wacker Drive, Suite 6400, Chicago, IL, the following plan of action will be implemented: Employees will contact or be contacted by either Mike Egan (cell 630-248-9480) or Susan Nowlin (cell 219-789-9339). All employees will be instructed to report to the residence of Ted Koenig, 1176 Lincoln Avenue South, Highland Park, IL (cell 847-226-7800) or to log in and conduct certain business from their home connection. If an employee is unable to contact either Mike Egan or Susan Nowlin or has not been contacted by Mike Egan or Susan Nowlin, the employee should report to the residence of Ted Koenig.

Back Office Resources
The Fund will utilize the capabilities of the fully integrated Monroe origination and asset management infrastructure. The existing staff includes over 50 experienced professionals, including 10 professionals in finance, accounting, compliance, operations and Treasury management.

Firm Track Record

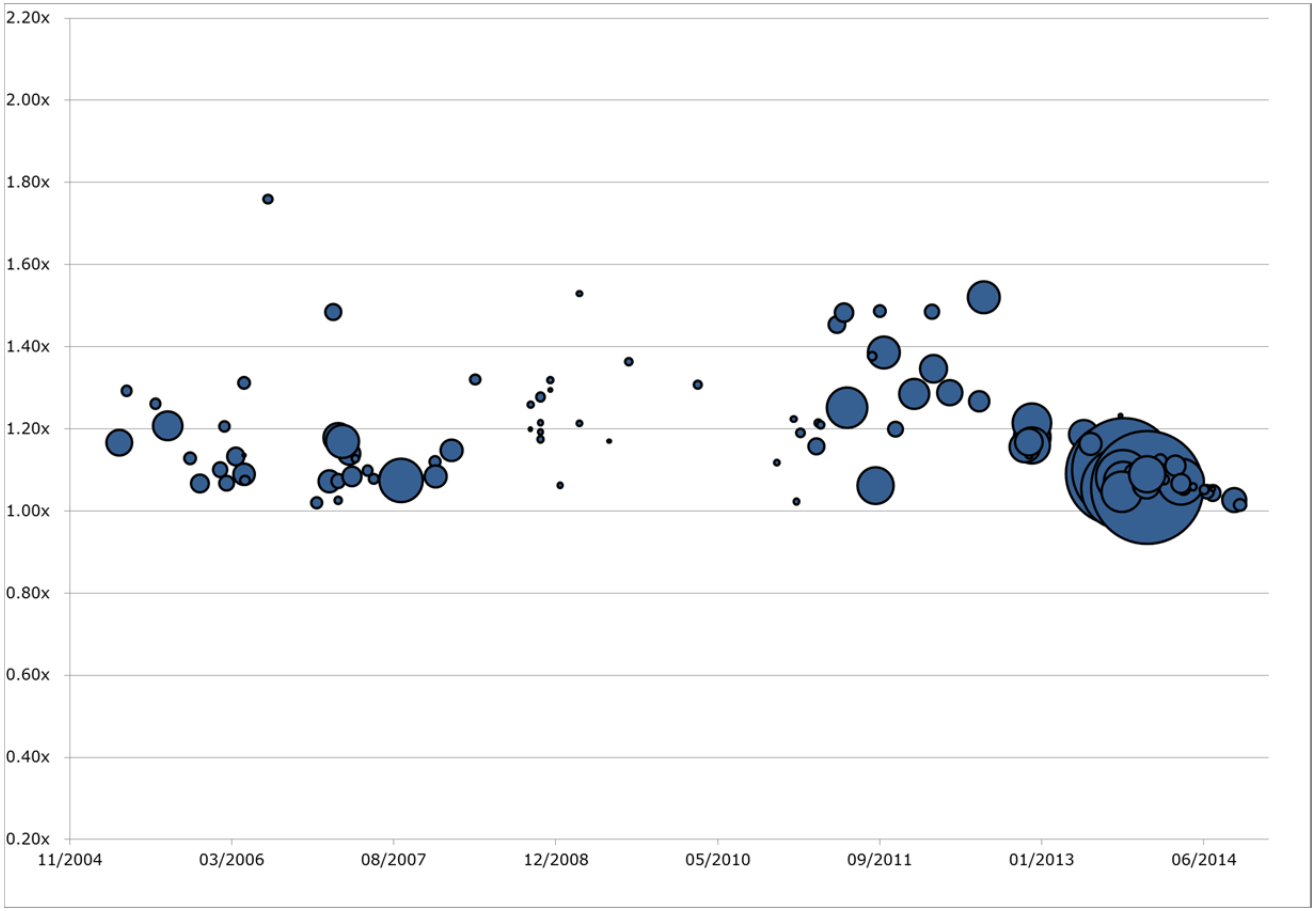
Past Fund Record

Fund-Level Returns									
Fund	Vintage Year	Capital Committed	Capital Funded	Reported Value	Amount Distributed	Total Value, Net of Carry	TVPI Multiple	DPI Multiple	Current Net IRR
Monroe I	2013	$140	$126	$140	$22	$163	1.26x	0.18x	14.1%
Monroe I (Unlevered)	2013	$233	$209	$224	$24	$248	1.17x	0.11x	8.6%
Monroe I (Offshore)	2013	$125	$109	$118	$11	$129	1.16x	0.10x	9.7%

Note: $ in millions and net of fees; data as of 3/31/2016, as provided by Monroe

Fund Attribution Analysis

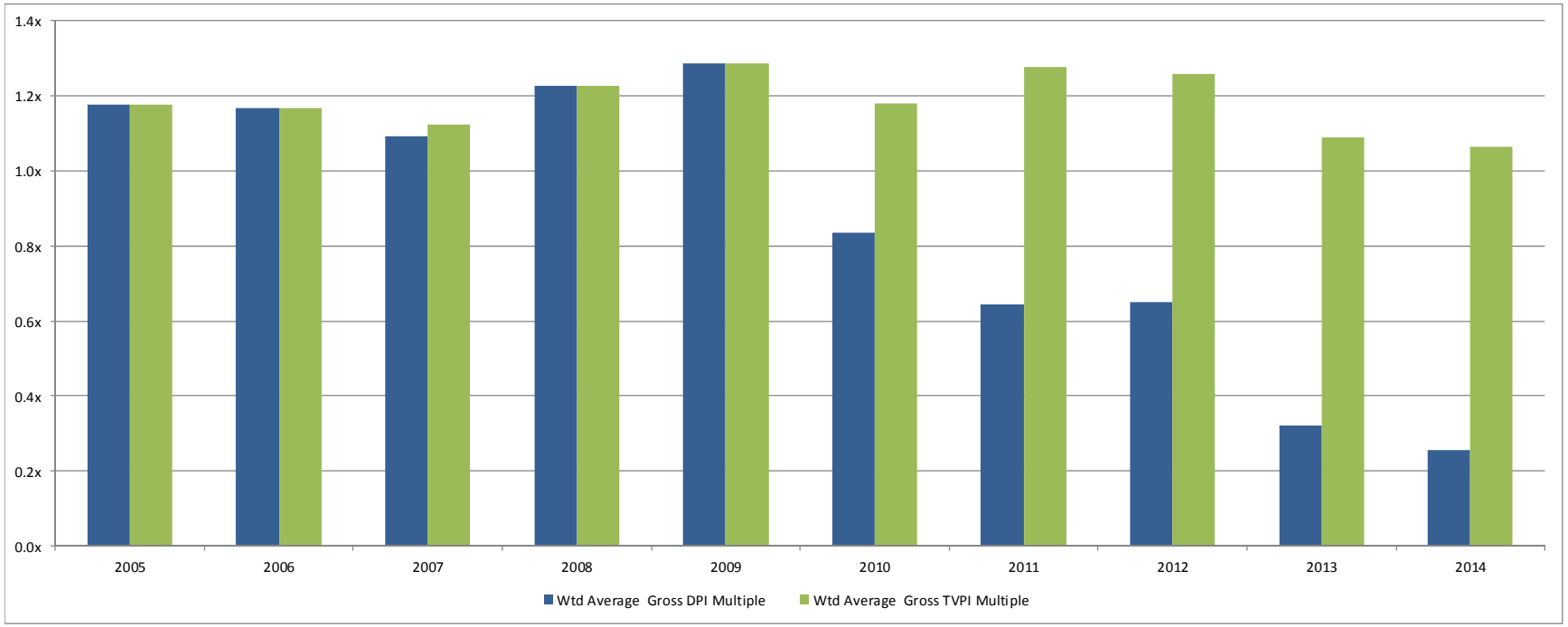
The chart below shows the individual investment total-value-to-paid-in capital, or TVPI, multiples for Monroe, including the team's track record at its predecessor firm, Hilco Capital.



Note: TVPI multiple represents the ratio of realized + current value to capital funded (current value based on fair market value as of 9/30/2014).

Monroe Capital Private Credit Fund II
Direct Lending Strategy

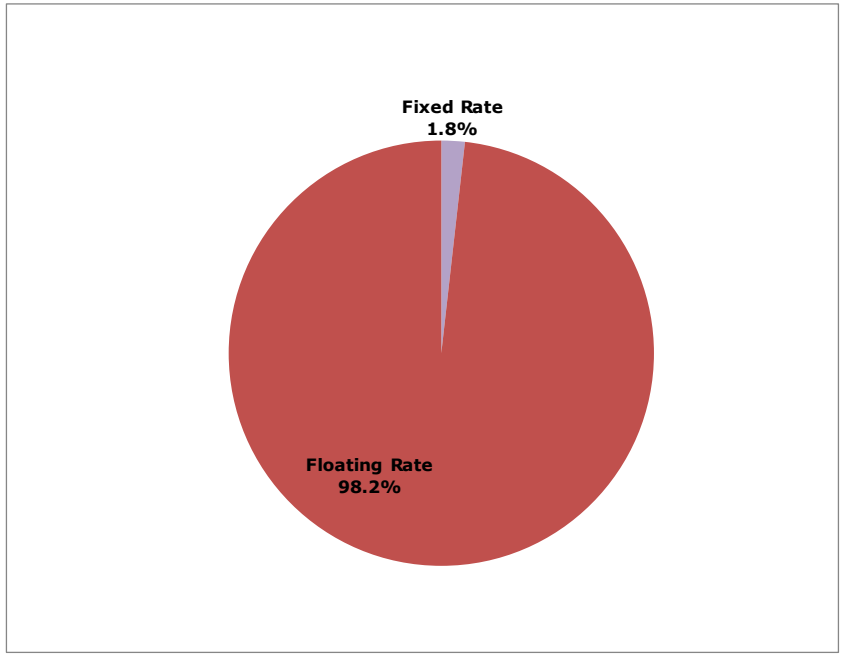
Weighted Average DPI and TVPI by Vintage Year of Investments

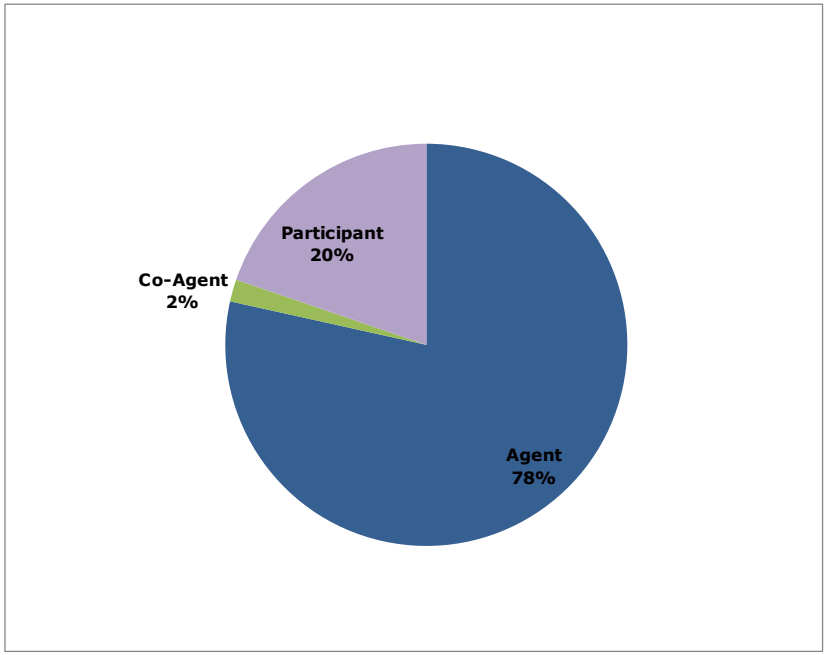


Vintage Year of Investments	Number of Investments	Equity Capital Invested	Amount Distributed	Current Reported Value	Total Value	Wtd Average Gross DPI Multiple	Wtd Average Gross TVPI Multiple	Average Gross TVPI Multiple	Average Gross IRR
2005	6	72.16	84.97	0.00	84.97	1.18x	1.18x	1.19x	20.16%
2006	10	83.69	97.69	0.00	97.69	1.17x	1.17x	1.19x	16.59%
2007	18	221.13	241.78	6.40	248.18	1.09x	1.12x	1.12x	11.54%
2008	10	53.17	65.22	0.00	65.22	1.23x	1.23x	1.24x	12.02%
2009	5	17.88	23.00	0.00	23.00	1.29x	1.29x	1.27x	49.95%
2010	4	17.20	14.37	5.93	20.31	0.84x	1.18x	1.17x	12.61%
2011	13	169.43	109.20	107.25	216.45	0.64x	1.28x	1.29x	15.44%
2012	11	202.53	131.87	123.23	255.11	0.65x	1.26x	1.27x	18.92%
2013	23	627.34	201.90	481.05	682.94	0.32x	1.09x	1.10x	15.26%
2014	18	184.92	47.31	149.73	197.04	0.26x	1.07x	1.06x	28.85%
	118	1649	1017	874	1891	0.62x	1.15x		

Monroe Capital Private Credit Fund II
Direct Lending Strategy

Fixed Rate vs Floating, Agent vs Participant Since Track Record Inception





Fixed vs Floating

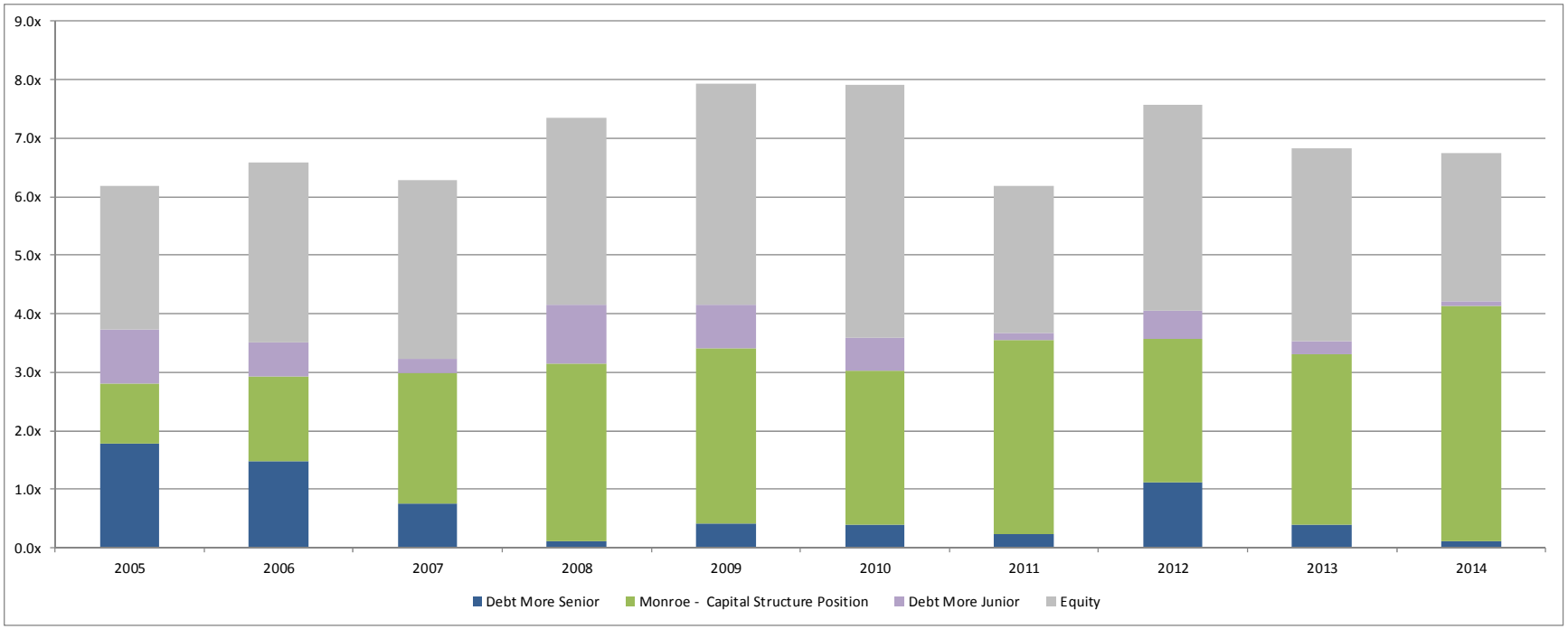
	Number of Investments	Equity Capital Invested	Amount Distributed	Current Reported Equity Value	Total Value	Wtd. Gross DPI Multiple	Wtd. Average Gross TVPI Multiple
Fixed Rate	4	26.8	42.8	0.0	42.8	1.60x	1.60x
Floating Rate	114	1487.4	1028.5	697.6	1726.1	0.69x	1.16x
Total		1514.2	1071.3	697.6	1768.9	0.71x	1.17x

Agent vs Participant

	Number of Investments	Equity Capital Invested	Amount Distributed	Current Reported Equity Value	Total Value	Wtd. Gross DPI Multiple	Wtd. Average Gross TVPI Multiple
Agent	71	1188.2	753.5	638.5	1392.0	0.63x	1.17x
Co-Agent	1	27.0	4.8	25.6	30.4	0.18x	1.13x
Participant	46	299.0	313.0	33.5	346.5	1.05x	1.16x
Total		1514.2	1071.3	697.6	1768.9	0.71x	1.17x

Monroe Capital Private Credit Fund II
Direct Lending Strategy

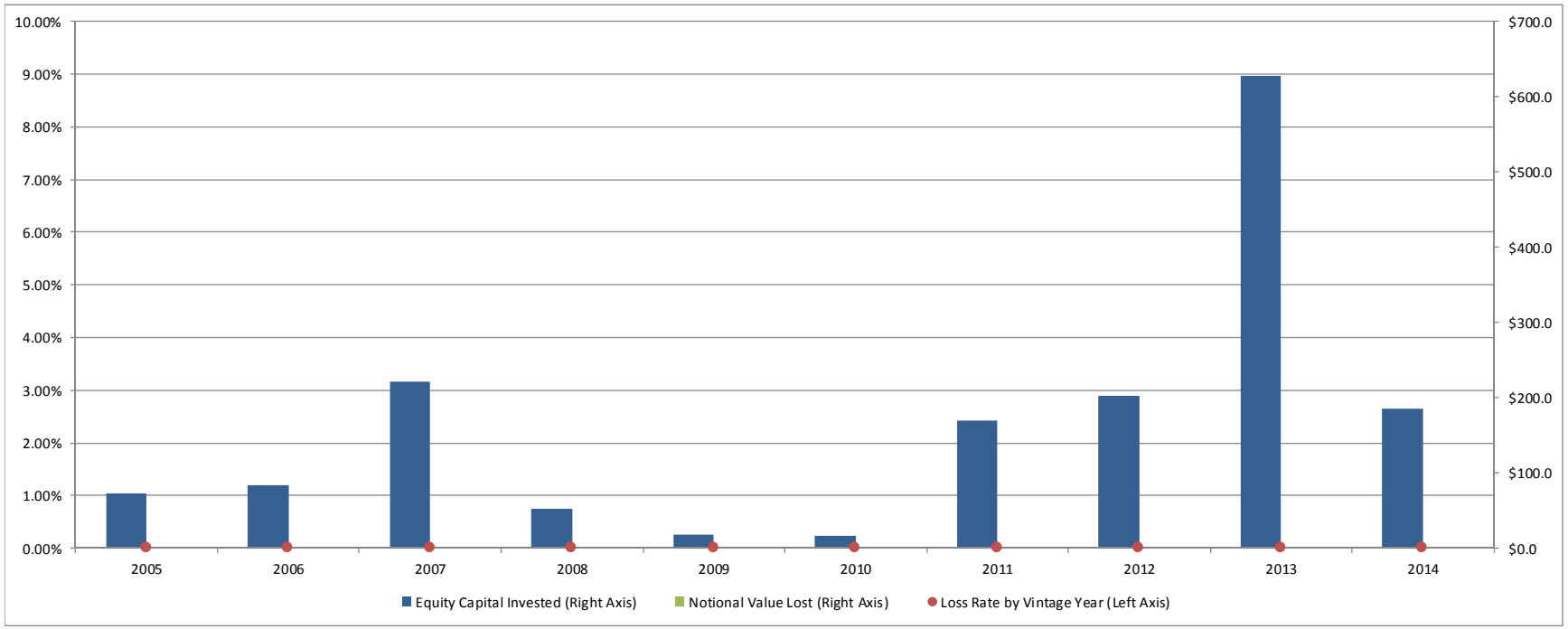
Position in Capital Structure by Year as a Multiple of EBITDA



			Averages at Investment								
Vintage Year of Investments	Number of Investments	Attachment Point	Leverage Multiple for Investment	Total Debt/EBITDA	EV/EBITDA	EBITDA/Total Interest	Fixed Charge Coverage	Expected IRR	Debt More Senior	Monroe - Capital Structure Position	Debt More Junior
2005	6	1.8	2.8	3.7	6.2	4.2	1.4	13.8%	1.77x	1.03x	0.93x
2006	10	1.5	2.9	3.5	6.6	3.7	1.4	12.0%	1.47x	1.46x	0.59x
2007	18	0.8	3.0	3.2	6.3	4.2	1.6	10.3%	0.76x	2.23x	0.23x
2008	10	0.1	3.2	4.1	7.4	4.5	1.5	10.6%	0.11x	3.05x	0.99x
2009	5	0.4	3.4	4.1	7.9	2.5	1.6	10.4%	0.40x	3.00x	0.74x
2010	4	0.4	3.0	3.6	7.9	3.2	2.0	9.8%	0.40x	2.63x	0.56x
2011	13	0.2	3.6	3.7	6.2	3.5	1.4	16.6%	0.23x	3.33x	0.13x
2012	11	1.1	3.6	4.1	7.6	3.0	1.4	16.1%	1.12x	2.46x	0.48x
2013	23	0.4	3.3	3.5	6.8	1.6	3.4	12.3%	0.40x	2.91x	0.23x
2014	18	0.1	4.1	4.2	6.7	NA	1.7	16.2%	0.12x	4.02x	0.08x

Monroe Capital Private Credit Fund II
Direct Lending Strategy

Equity Capital Invested by Year Including Realized + Unrealized Loss Rate



Vintage Year of Investments	Number of Investments	Number of Investments Below Cost	Equity Capital Invested (Right Axis)	Equity Capital Invested Below Cost	Total Value Below Cost	Notional Value Lost (Right Axis)	Loss Rate by Vintage Year (Left Axis)
2005	6	0	72.2	0.0	0.0	0.0	0.00%
2006	10	0	83.7	0.0	0.0	0.0	0.00%
2007	18	0	221.1	0.0	0.0	0.0	0.00%
2008	10	0	53.2	0.0	0.0	0.0	0.00%
2009	5	0	17.9	0.0	0.0	0.0	0.00%
2010	4	0	17.2	0.0	0.0	0.0	0.00%
2011	13	0	169.4	0.0	0.0	0.0	0.00%
2012	11	0	202.5	0.0	0.0	0.0	0.00%
2013	23	0	627.3	0.0	0.0	0.0	0.00%
2014	18	0	184.9	0.0	0.0	0.0	0.00%
Total	118	0	1649.4	0.0	0.0	0.0	0.00%

Key Fund Professionals

Summary of Key Professionals

Name	*Title*	*Years with Firm*	*Years of Relevant Experience*	*Percent of Time Dedicated to Fund II*
Theodore Koenig	CEO/President	10	31	>50%
Michael Egan	Chief Credit Officer	10	30	100%
Thomas Aronson	Head of Originations	10	28	100%
Jeremy VanDerMeid	Portfolio Manager	8	16	<50%
Zia Uddin	Portfolio Manager	7	22	100%
Aaron Peck	Portfolio Manager	2	20	<50%
Alex Franky	Head of Underwriting	10	22	100%

Detailed Biographies

Theodore Koenig, CEO/ President
Mr. Koenig is responsible for executive management, strategic initiatives, and company direction and policy at Monroe. He has over 31 years of experience in structuring, negotiating and closing transactions on behalf of asset-based lenders, commercial finance companies, financial institutions and private equity investors. Prior to founding Monroe in 2004, Mr. Koenig served as the President and Chief Executive Officer of Hilco Capital from 1999 to 2004, where he invested in a variety of debt transactions. Prior to Hilco Capital, he was a Partner with the Chicago-based corporate law firm, Holleb & Coff, and an Associate with Winston & Strawn. Mr. Koenig is also a Director of the Commercial Finance Association and a member of the Turnaround Management Association, Association for Corporate Growth and the Executives' Club of Chicago. He is a graduate of the Kelley School of Business at Indiana University with a B.S. in accounting with high honors. He also has a J.D. with honors from the Chicago-Kent College of Law.

Michael Egan, Chief Credit Officer
Mr. Egan is responsible for credit policies and procedures, portfolio and asset management operations at Monroe. He has over 30 years of experience in commercial finance, credit administration banking, and distressed investing. Prior to Monroe, Mr. Egan served as Executive Vice President and Chief Credit Officer of Hilco Capital from 1999 to 2004. Prior to Hilco Capital, Mr. Egan was with CIT Group/ Business Credit, Inc., for a 10-year period beginning in 1989, where he was Senior Vice President and Regional Manager responsible for all credit, new business and operational functions for the Midwest region of the United States. Prior to CIT Group, Mr. Egan was a commercial lending officer with The National Community Bank of New Jersey (The Bank of New York) and a credit analyst with Key Corp, where he completed a formal management and credit training program. He received a B.S. in Business Management from Ithaca College. He is also a graduate of the American Bankers Association Commercial Lending School at the University of Oklahoma and is a member of the Commercial Finance Association and the Turnaround Management Association.

Thomas Aronson, Head of Originations
Mr. Aronson is responsible for leading all transaction sourcing efforts and structuring investments at Monroe. He has over 26 years of lending and credit experience. Prior to Monroe, he served at Hilco Capital, sourcing, structuring and underwriting debt transactions since 2002. Prior to Hilco Capital, he was Senior Vice President and headed the Business

Banking Group of Cole Taylor Bank, where he was responsible for asset-based lending, correspondent banking, public funds and a commercial lending division. Mr. Aronson also served for seven years as a commercial lender with American National Bank (now JP Morgan Chase Bank) and as Chief Financial Officer of Barton Chemical Corporation, a privately held consumer products company. Mr. Aronson holds a B.S. in Finance and Marketing from Indiana University and an M.B.A. in Management Accounting from DePaul University. He is a member of the Commercial Finance Association, the Turnaround Management Association and the Association for Corporate Growth.

Jeremy VanDerMeid, Portfolio Manager
Mr. VanDerMeid is responsible for managing Monroe's CLO business, executing buy-side transactions, and originating middle-market club transactions. Mr. VanDerMeid has over 16 years of credit, lending and corporate finance experience. Prior to Monroe, Mr. VanDerMeid was with Morgan Stanley Investment Management in the Van Kampen Senior Loan Group. He managed a portfolio of bank loans for Van Kampen and also led the firm's initiative to increase its presence with middle-market lenders and private equity firms. Prior to Morgan Stanley, he worked for Dymas Capital and Heller Financial, where he originated, underwrote, and managed various middle-market debt transactions. Mr. VanDerMeid holds a B.B.A. from the University of Michigan's Ross School of Business and an M.B.A. from Northwestern University's Kellogg School of Business.

Zia Uddin, Portfolio Manager
Mr. Uddin is responsible for portfolio management, sourcing investment transactions, investment structuring and execution, investment due diligence, investment monitoring and fund administration at Monroe. He has over 22 years of management consulting, corporate finance, turnaround and investing experience. Prior to Monroe, Mr. Uddin was involved with private equity and venture capital investing as a Principal at Franklin Street Equity Partners LP and Pharos Equity. Prior to his work at Franklin Street Equity Partners LP, he worked at Arthur Andersen LLP on various management and strategic consulting engagements, including divestures, acquisitions, valuations, turnarounds and operational and financial assignments. Mr. Uddin also co-founded the Economics practice within Arthur Andersen LLP. He earned his M.B.A. from the University of Chicago Booth School of Business and a B.S. from University of Illinois. He is a Chartered Financial Analyst and Certified Public Accountant.

Aaron Peck, Portfolio Manager
Mr. Peck is the Chief Investment Officer of Monroe Capital Corporation's publicly held business development company (NASDAQ:MRCC), portfolio management and other strategic initiatives. He has over 20 years of experience in credit, lending, high yield and public company operations and investor relations. Prior to Monroe, Mr. Peck was Chief Investment Officer at Deerfield Capital Management and had responsibility for all of the investment teams at Deerfield, including syndicated and middle-market loan teams which managed over $5 billion in assets. Mr. Peck was also chief portfolio manager for Deerfield's publicly-traded specialty finance mortgage REIT and, in that capacity, was the key point of contact for all institutional and retail investors, investment banking research analysts, lenders and investment bankers. Prior to Deerfield, he worked in leveraged credit at several investment firms, including AEG Investors, Black Diamond Capital, Salomon Smith Barney, and ESL Investments. Mr. Peck earned his M.B.A. with honors from the University of Chicago Booth School of Business and a B.S. in Commerce from The University of Virginia, McIntire School of Commerce.

Alex Franky, Head of Underwriting
Mr. Franky is responsible for investment structuring and investment execution at Monroe. He has over 22 years of lending experience. Prior to Monroe, he served at Hilco Capital underwriting middle-market loan transactions. Mr. Franky began his career at LaSalle Bank and also held positions at GMAC Business Credit and FINOVA Capital Corp, where he assembled, negotiated and closed various middle-market debt transactions. He earned his

B.S. in Accounting from University of Illinois at Chicago and his M.B.A. in Finance and International Business from Loyola University.

Disclaimers and Disclosures

- Past performance is no guarantee of future results.
- The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.
- Information on market indices was provided by sources external to NEPC, and other data used to prepare this report was obtained directly from the investment manager(s). While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.
- This report may contain confidential or proprietary information and may not be copied or redistributed to any party not legally entitled to receive it.

In addition, it is important that investors understand the following characteristics of non-traditional investment strategies including hedge funds, real estate and private equity:

1. Performance can be volatile and investors could lose all or a substantial portion of their investment
2. Leverage and other speculative practices may increase the risk of loss
3. Past performance may be revised due to the revaluation of investments
4. These investments can be illiquid, and investors may be subject to lock-ups or lengthy redemption terms
5. A secondary market may not be available for all funds, and any sales that occur may take place at a discount to value
6. These funds are not subject to the same regulatory requirements as registered investment vehicles
7. Managers may not be required to provide periodic pricing or valuation information to investors
8. These funds may have complex tax structures and delays in distributing important tax information
9. These funds often charge high fees
10. Investment agreements often give the manager authority to trade in securities, markets or currencies that are not within the manager's realm of expertise or contemplated investment strategy

NEPC, LLC

YOU DEMAND MORE. So do we.SM

Attachment B

Dallas P&F Pension System

Private Markets Program Review & 2016 Strategic Investment Plan

~ Abbreviated Abstract ~

March 10, 2016

Rhett Humphreys, CFA, Partner
Keith Stronkowsky, CFA, Sr. Consultant
Jeff Roberts, Sr. Research Consultant – Private Markets

Private Equity Update

General Market Thoughts

- **Venture and Growth Equity: Unicorns or pack mules with pointy party hats?**
  - Top quartile returns have been attractive, but access to brand names is still difficult; risk/return tradeoff of ventures outside of the top quartile is questionable
  - Fundraising has remained steady and doesn't appear to be out of line, but valuations, investment volume and average deal sizes have significantly increased over the past two years
- **Buyouts & Special Situations: Historically a Steady Eddie through market cycles**
  - Purchase prices remain near all time highs in developed geographies; however while prices are elevated, the amount of equity in transactions has also risen, a departure from the last buyout "boom"
  - Despite heady times, sponsors have proven their ability to preserve capital, with median investment multiples from the last buyout boom rebounding to 1.5x-1.6x with continued upside potential
  - Greater industry specialization and operational capabilities from firms seeking to outperform peers
- **Distressed Debt & Opportunistic Credit: Wait until you see the whites of their eyes!**
  - Low default environment with ample available capital continues to create challenging environment for distressed opportunities (excluding the energy sector where distress is flowing)
  - In Europe, over $1 trillion of NPLs still exist on the balance sheets of banks and Basel III continues to lead banks to sell these assets
- **Mezzanine and Direct Lending: Lower returns and changing fund/fee structures**
  - For mezzanine, debt multiples are back to 2007 levels, while dry powder is at an all time high and mezzanine has become a much smaller portion of the capital structure
  - Direct lending continues to offer attractive income relative to liquid markets, however, recent pullbacks in the public credit markets have narrowed the gap
- **Secondaries, Fund of Funds and Co-Investment Funds: Creativity and alpha!**
  - Competition for "plain vanilla" secondary transactions is high; be complex, small or specialized
  - FOFs provide investors with beta PE exposure, albeit with the cost of an additional layer of fees; Co-investment funds provide good diversification at fee structures that are less than most direct funds

General Private Equity and Private Credit: Implementation Views

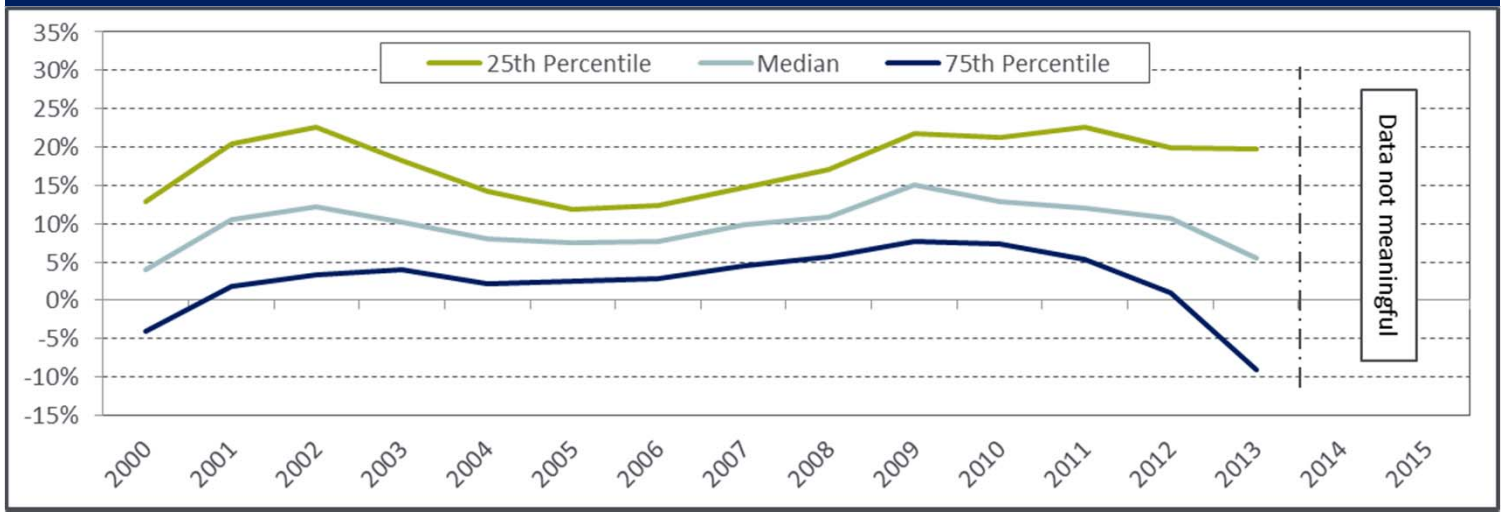
Implementation Views			
Strategy		**Outlook**	**Commentary**
Venture Capital & Growth Equity	Early Stage	0	• Managers with deep networks and technical or operational expertise can increase the size of the pie for the entrepreneur; Robust or differentiated sourcing is key
	Mid & Late Stage	-	• Mid and late stage investors' upside may get squeezed by later round investors' liquidation preferences
	Growth Equity	0	• Look for managers that can help build the organization; deep networks are important for strategic partnerships/ M&A support; given current valuations, find managers that have historically protected down side
Buyouts & Special Situations	US Mega & Large	0	• Seek value-oriented managers or those with industry or operational focus • Evaluate special situations managers able to capitalize on prolonged uncertain recovery
	US Mid & Small	+	
	Special Sits & Turnarounds	+	
	European	0	• Seek regional or pan-European managers targeting companies that do not rely on the EU as their primary end market
	Asian	+	• Seek managers with strong local networks and those with industry or operational focus to drive growth & profitability • Consider specialized FOFs as option to balance diversification with access to country specific firms, small funds & co-investments

General Private Equity and Private Credit: Implementation Views (Cont.)

Implementation Views			
Strategy		**Outlook**	**Commentary**
Distressed Debt & Opp. Credit.	Distressed Debt	0	• Conserve capital and invest when signs of a distress cycle appear
	Opportunistic Credit	+	• Target flexible, multifaceted managers
Mezzanine & Direct Lending	Mezzanine	-	• Few strong performers in the asset class • Identify outliers with attractive fee structures
	US Direct Lending	0	• Pursue lower-middle and middle market lenders vs large cap managers in US • For larger structural imbalances pursue lending opportunities in Europe and Asia
	Europe & Asia Direct Lending	+	
Secondaries		0	• In current environment, the best opportunities are with those firms who can minimize competition through sourcing strategies, deal complexity, investment focus or single interest transactions • Secondary commitments can serve as a hedge to primary fund commitments and reduce overall PE portfolio volatility
Fund of Funds & Co-Investment Funds	Specialized FOFs	0	• Diversified fund of funds are best used to easily capture private equity beta while minimizing its administrative duties • Specialized fund of funds can be an effective way for investors to access sectors of private equity where direct investing is more difficult, time consuming or access constrained
	Global/Multi-Strategy FOFs	-	
	Co-Investment Funds	0	• Seek firms with strong GP relationships and wide sourcing networks; both should enable co-investment fund managers to see a wide range of good investment opportunities • Co-investment fund managers need to have a combination of direct deal and fund evaluation skills

General Private Equity and Private Credit: Returns and Fundraising

Vintage Year Net IRRs



Annual Fundraising

Source: Thomson Reuters/Cambridge Associates, Preqin

Dallas Police and Fire Pension

NEPC Recommendations

- **Dallas P&F Pension System (DPFP) should consider a $50 million allocation for vintage year 2016 funds:**
  - $10 million to venture/secondaries
    - Opportunity to take advantage of what appears to be a resetting of valuations within venture capital
    - NEPC has identified a leading manager that is currently raising both a secondary and fund of funds vehicle targeting venture capital interests
  - $10 million to buyout/special situations
    - Add a high quality manager to anchor the private equity program
  - $30 million to private credit strategies
    - Add additional managers to take advantage of recent turmoil in the energy market, sluggish global growth, and volatile markets which may portend to a distress cycle taking shape
    - NEPC has identified a manager poised to take advantage of the dislocation in the energy market and lack of available capital to energy producers

- **Although DPFP is expected to be over-allocated to private markets over the next few years (currently ~15%), a baseline commitment to private markets will allow DPFP to remain an active investor in the asset class while distributions from earlier commitments will outweigh new contributions, gradually bringing the Plan back into balance**

- **DPF should maintain an active commitment pace in each vintage year going forward, being mindful of the Plan's liquidity needs**
  - Annual commitments need to be assessed carefully so as to not over-allocate to illiquid investments
  - Strategies that provide a combination of capital appreciation as well as near-term income or distributions can provide a balanced approach for maintaining private markets exposure while also providing some liquidity

Current Investment Program & Allocation – Private Equity

General Plan Assumptions

Total Plan Assets	$2,776
Total Private Equity Assets	$393
Private Equity Capital to be Funded	$246
Total Private Equity Exposure	$639
Total Private Equity Assets / Total Plan Assets	14.2%
Total Private Equity Exposure / Total Plan Assets	23.0%
Target Private Equity Allocation % (Current Target)	5.0%

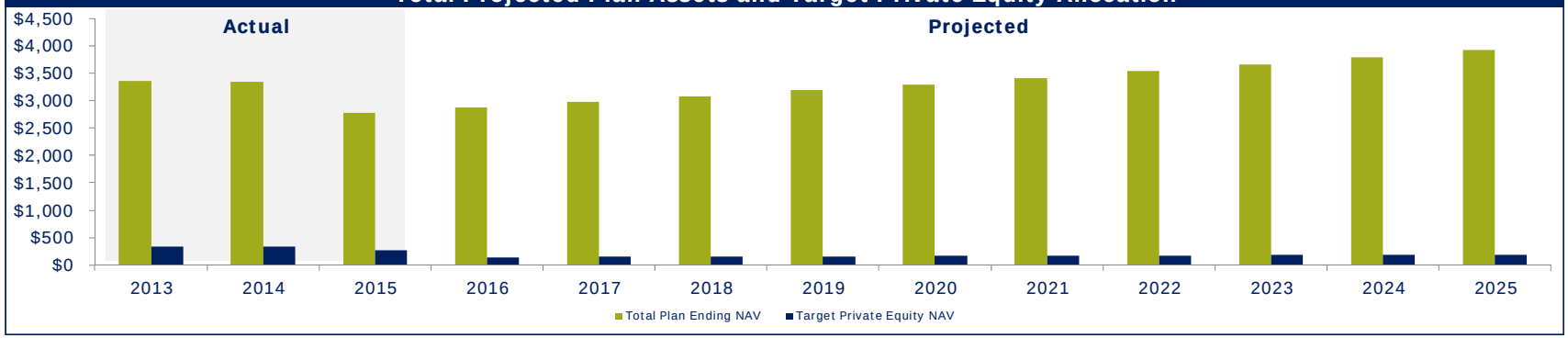
Plan Return Assumptions	2016	2017	2018
Net Growth Rate %	3.50%	3.50%	3.50%

Plan Data as of:	12/31/2015
Private Equity Data as of:	9/30/2015

Total Projected Plan Assets

	Actual			Projected									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total Plan Net Growth Rate	4.6%	(0.2%)	(17.0%)	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Total Plan Beginning NAV	$3,204	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783
Yearly Net Growth	$147	($6)	($568)	$97	$101	$104	$108	$111	$115	$119	$124	$128	$132
Total Plan Ending NAV	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783	$3,916
Target Private Equity Allocation	10.0%	10.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Target Private Equity NAV	$335	$334	$278	$144	$149	$154	$159	$165	$171	$177	$183	$189	$196

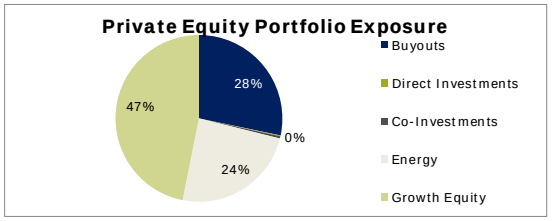
Total Projected Plan Assets and Target Private Equity Allocation



Plan Overview and Assumptions – Private Equity

Private Equity NAVs and Exposures

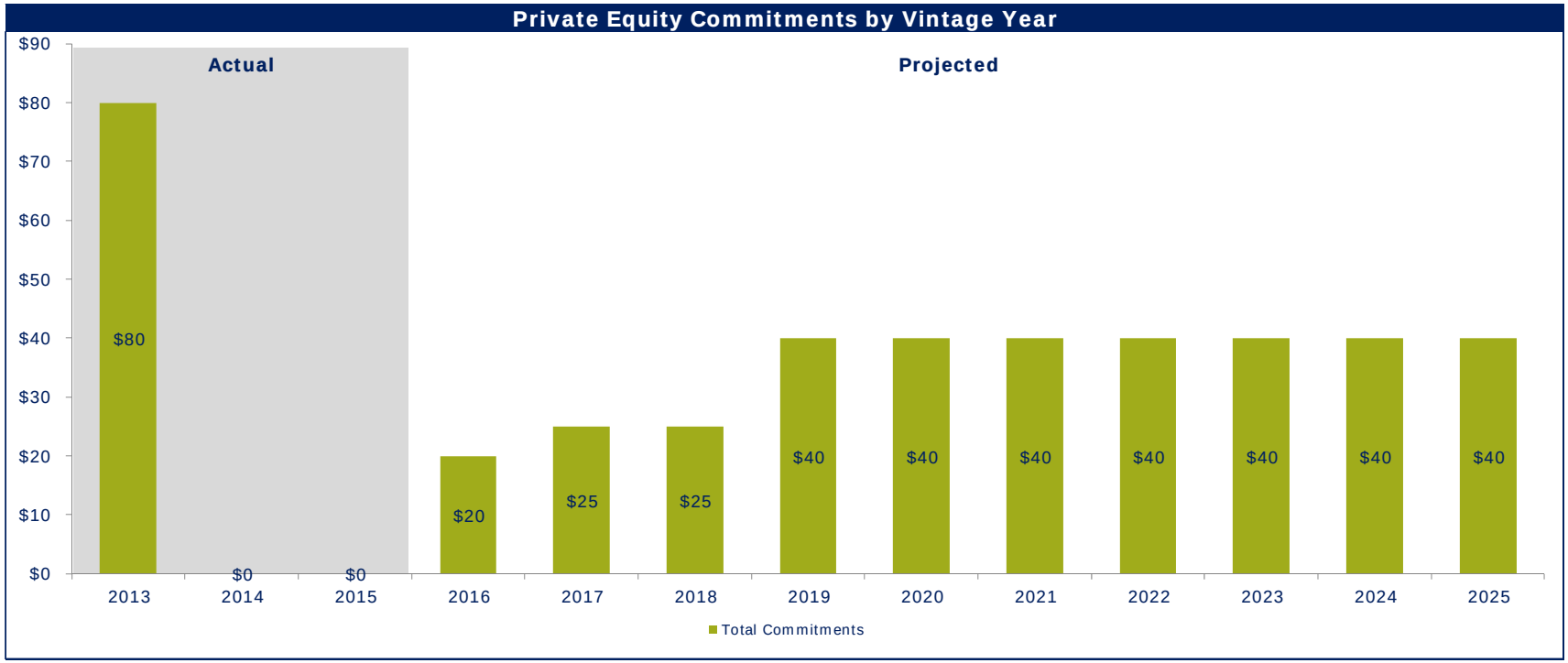
Investment Strategy	Current Valuation (NAV)	Capital to be Funded	Total Current Exposure	% of Total Exposure
Buyouts	$116.9	$63.8	$180.7	28%
Direct Investments	$1.1	$0.0	$1.1	0%
Co-Investments	$2.9	$0.0	$2.9	0%
Energy	$152.9	$2.2	$155.0	24%
Growth Equity	$119.3	$180.4	$299.6	47%
Total / Wtd. Avg.	$392.9	$246.4	$639.3	100%



Private Equity Investments by Vintage Year

Vintage Year	Commitment	Paid In Capital	Capital to be Funded	Cumulative Distributed	Current Valuation (NAV)	Total Value	Net Benefit	Call Ratio	DPI Ratio	TVPI Ratio
1997	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
1998	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
1999	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2000	$77	$77	$0	$62	$35	$97	$8	100%	0.80x	1.27x
2001	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2002	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2003	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2004	$7	$7	$0	$13	$3	$16	$9	100%	1.80x	2.26x
2005	$29	$29	$0	$15	$17	$31	$3	99%	0.51x	1.09x
2006	$116	$113	$16	$17	$123	$140	$28	97%	0.15x	1.24x
2007	$58	$52	$0	$13	$17	$29	($24)	90%	0.24x	0.56x
2008	$242	$176	$73	$173	$79	$252	$74	73%	0.98x	1.43x
2009	$25	$25	$0	$4	$18	$22	($3)	99%	0.15x	0.87x
2010	$10	$8	$0	$1	$7	$7	($1)	82%	0.09x	0.89x
2011	$30	$18	$12	$10	$13	$23	$5	61%	0.55x	1.27x
2012	$125	$21	$104	$1	$27	$27	$6	17%	0.04x	1.29x
2013	$80	$54	$41	$3	$55	$59	$5	68%	0.06x	1.08x
2014	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2015	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
Total Private Equity	$798	$580	$246	$311	$393	$704	$110	73%	0.54x	1.21x

Commitment Pace Going Forward – Private Equity

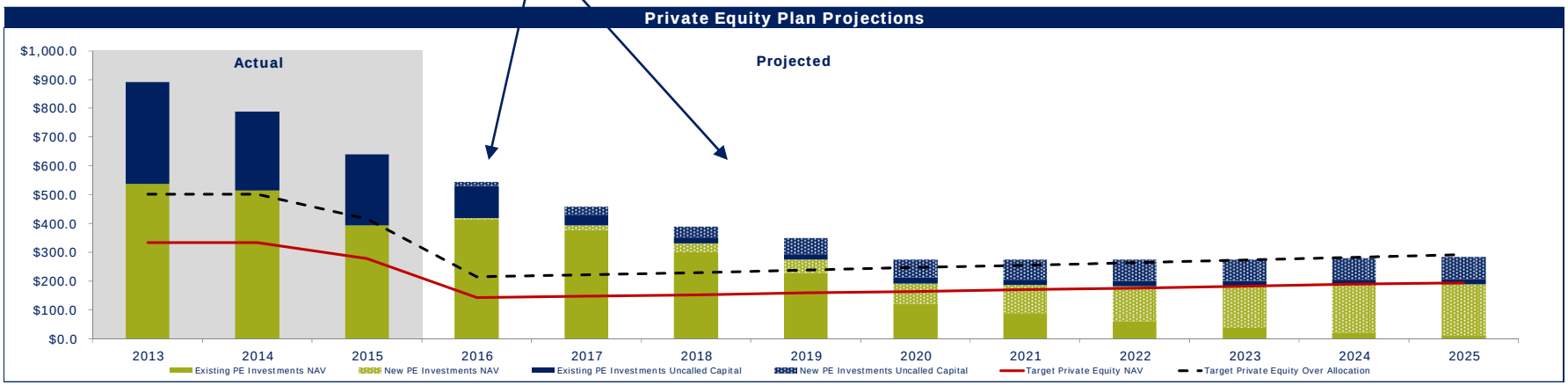


Private Equity Commitments by Vintage Year

	Actual			More Certain			Less Certain						
Year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Total Commitments	$80	$0	$0	$20	$25	$25	$40	$40	$40	$40	$40	$40	$40

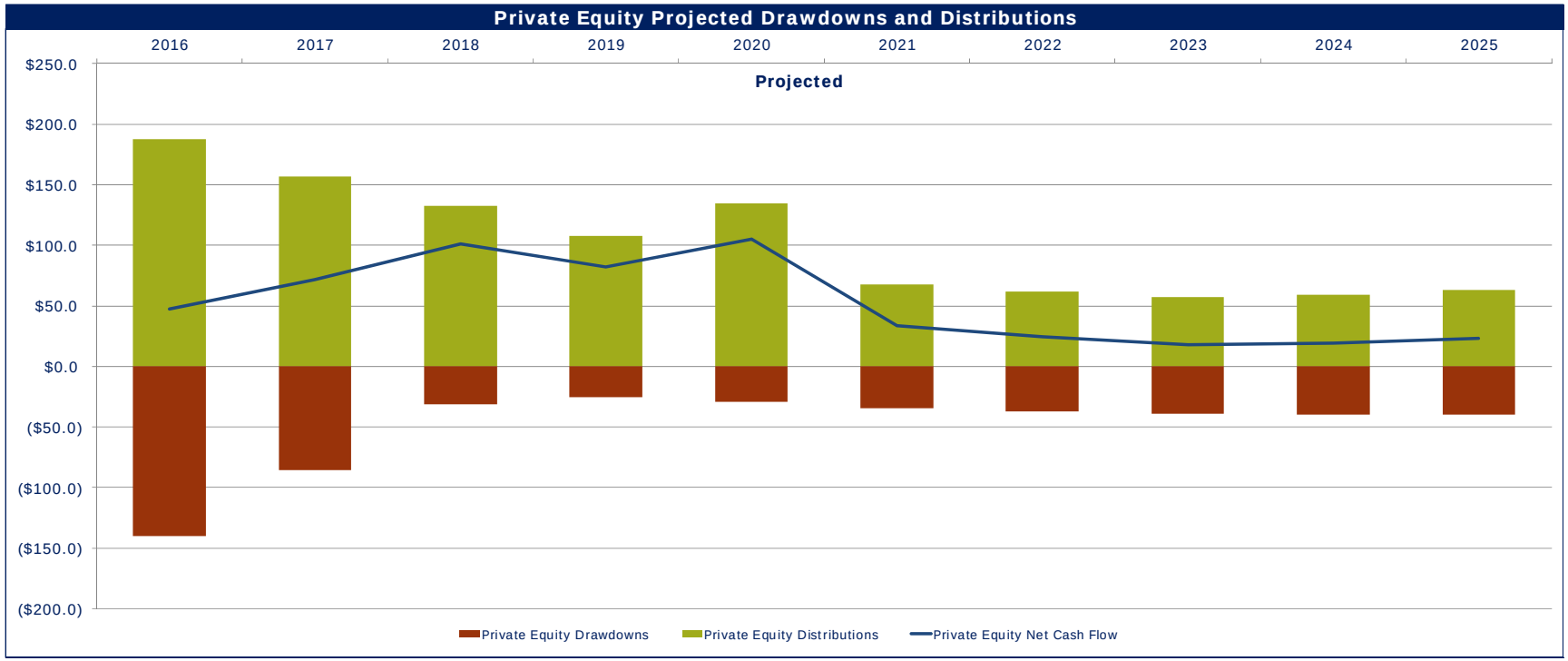
Fund Projections

- **Red line** is the [5%] target private equity allocation based on projected plan total NAV; **Black dashed line** is the 1.5x over-commitment.
- Goal is to keep private equity NAV (**green bar**) plus uncalled capital commitments (**blue bar**), between red line and black dashed line.



	Actual			Projected									
Year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Private Equity NAV	$537	$513	$393	$419	$393	$329	$275	$191	$184	$181	$181	$184	$189
Uncalled Capital Commitments	$354	$276	$246	$126	$65	$59	$73	$84	$89	$92	$93	$93	$93
Private Equity NAV + Uncalled Capital Commitments	$891	$789	$639	$545	$458	$388	$348	$275	$274	$273	$274	$278	$282
Target Private Equity NAV	$335	$334	$278	$144	$149	$154	$159	$165	$171	$177	$183	$189	$196
Over-Commitment Pace	1.5x	1.5x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x
Target Private Equity Over Allocation	$503	$502	$416	$215	$223	$231	$239	$247	$256	$265	$274	$284	$294
Beginning Plan NAV	$3,204	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783
Yearly Return	$147	($6)	($568)	$97	$101	$104	$108	$111	$115	$119	$124	$128	$132
Ending Plan NAV	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783	$3,916
Private Equity Percent of Total Plan Assets													
Private Equity NAV	16.0%	15.3%	14.2%	14.6%	13.2%	10.7%	8.6%	5.8%	5.4%	5.1%	4.9%	4.9%	4.8%
Private Equity Uncalled Capital Commitments	10.6%	8.2%	8.9%	4.4%	2.2%	1.9%	2.3%	2.5%	2.6%	2.6%	2.5%	2.5%	2.4%
NAV + Uncalled Capital Commitments	26.6%	23.6%	23.0%	19.0%	15.4%	12.6%	10.9%	8.3%	8.0%	7.7%	7.5%	7.3%	7.2%
Target Private Equity Allocation	10.0%	10.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

Private Equity Cash Flows



	Projected									
Year	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Private Equity Drawdowns	($140)	($86)	($31)	($26)	($30)	($34)	($37)	($39)	($40)	($40)
Private Equity Distributions	$187	$157	$132	$108	$135	$68	$62	$57	$59	$63
Private Equity Net Cash Flow	$47	$71	$101	$82	$105	$33	$24	$18	$20	$23

Current Investment Program & Allocation – Private Credit

General Plan Assumptions

Total Plan Assets	$2,776
Total Private Credit Assets	$72
Private Credit Capital to be Funded	$41
Total Private Equity Exposure	$113
Total Private Credit Assets / Total Plan Assets	2.6%
Total Private Credit Exposure / Total Plan Assets	4.1%
Target Private Credit Allocation % (Current Target)	5.0%

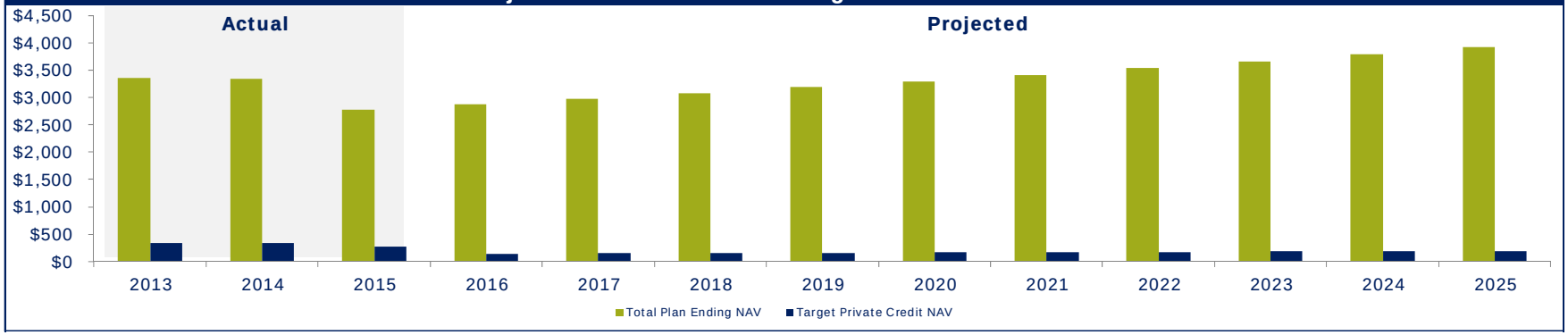
Plan Return Assumptions	2016	2017	2018
Net Growth Rate %	3.50%	3.50%	3.50%

Plan Data as of:	12/31/2015
Private Credit Data as of:	9/30/2015

Total Projected Plan Assets

	Actual			Projected									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total Plan Net Growth Rate	4.6%	(0.2%)	(17.0%)	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Total Plan Beginning NAV	$3,204	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783
Yearly Net Growth	$147	($6)	($568)	$97	$101	$104	$108	$111	$115	$119	$124	$128	$132
Total Plan Ending NAV	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783	$3,916
Target Private Credit Allocation	10.0%	10.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Target Private Credit NAV	$335	$334	$278	$144	$149	$154	$159	$165	$171	$177	$183	$189	$196

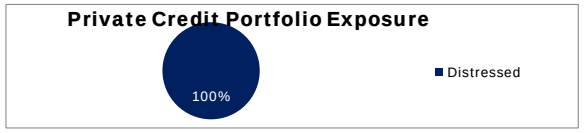
Total Projected Plan Assets and Target Private Credit Allocation



Plan Overview and Assumptions – Private Credit

Private Credit NAVs and Exposures

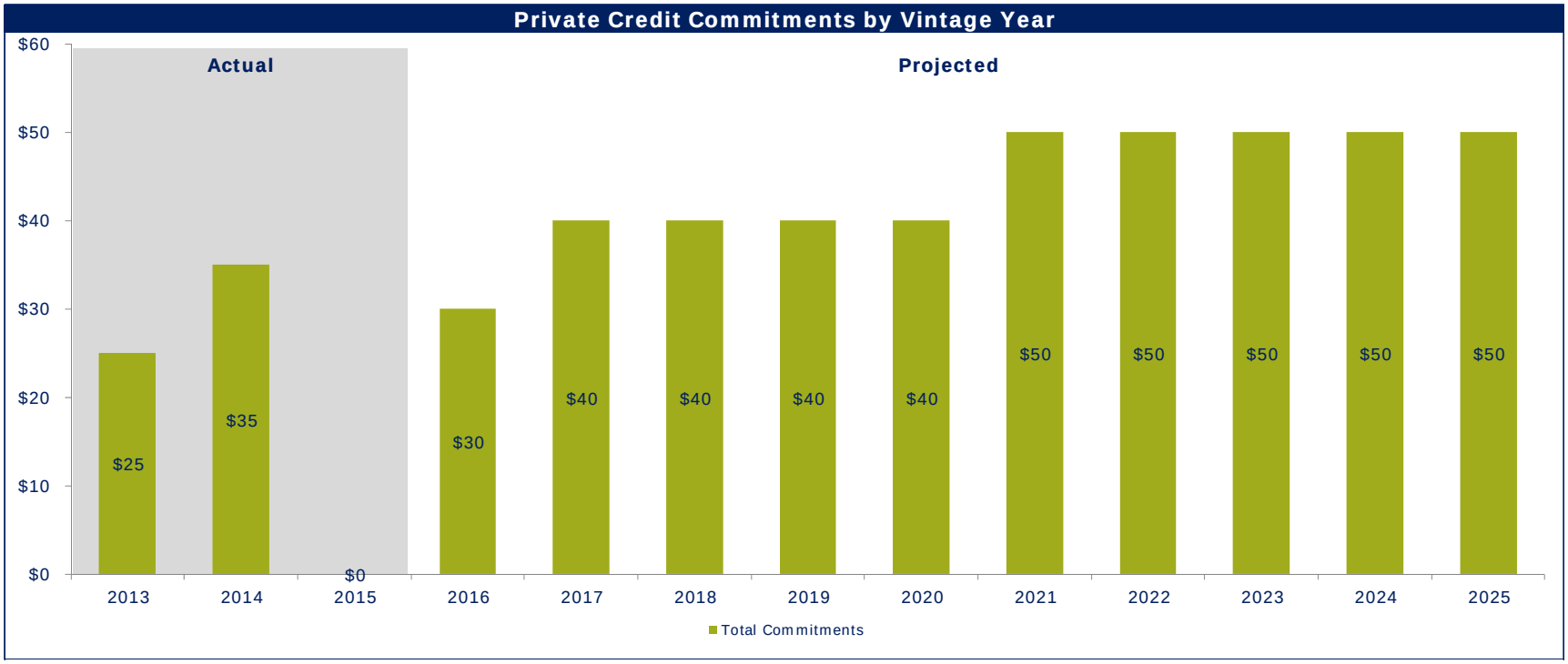
Investment Strategy	Current Valuation (NAV)	Capital to be Funded	Total Current Exposure	% of Total Exposure
Distressed	$71.8	$41.1	$112.9	100%
Total / Wtd. Avg.	$71.8	$41.1	$112.9	100%



Private Credit Investments by Vintage Year

Vintage Year	Commitment	Paid In Capital	Capital to be Funded	Cumulative Distributed	Current Valuation (NAV)	Total Value	Net Benefit	Call Ratio	DPI Ratio	TVPI Ratio
1997	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
1998	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
1999	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2000	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2001	$50	$50	$0	$82	$0	$83	$33	100%	1.65x	1.65x
2002	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2003	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2004	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2005	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2006	$75	$75	$0	$73	$18	$91	$5	100%	0.98x	1.21x
2007	$130	$130	$0	$101	$8	$108	($22)	100%	0.77x	0.83x
2008	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2009	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2010	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
2011	$25	$23	$2	$38	$5	$43	$19	94%	1.61x	1.83x
2012	$25	$20	$5	$0	$20	$20	($0)	79%	0.00x	0.99x
2013	$25	$20	$5	$12	$15	$28	$8	78%	0.64x	1.43x
2014	$35	$6	$29	$0	$6	$6	$0	18%	0.01x	1.02x
2015	$0	$0	$0	$0	$0	$0	$0	NA	NA	NA
Total Private Credit	$365	$324	$41	$306	$72	$378	$43	89%	0.95x	1.17x

Commitment Pace Going Forward – Private Credit



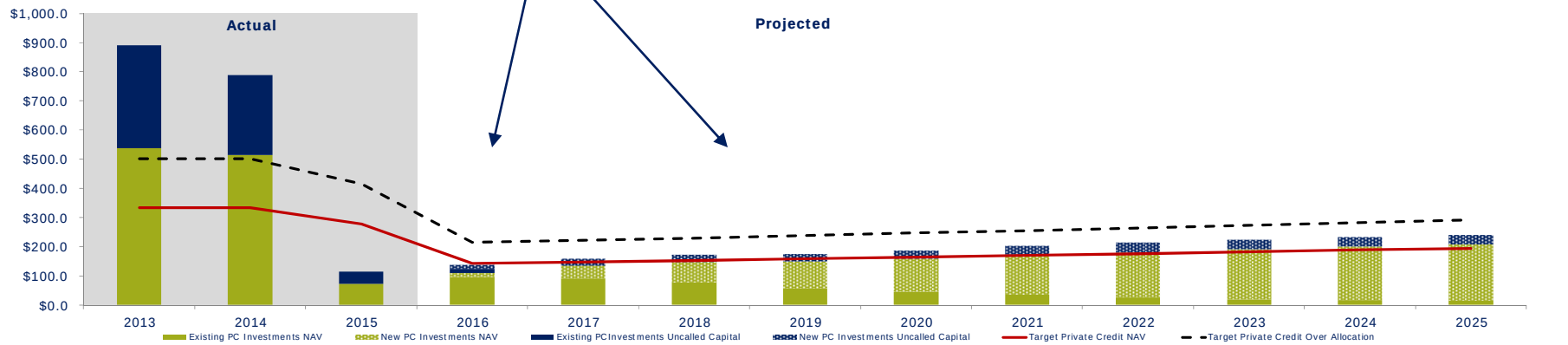
Private Credit Commitments by Vintage Year

	Actual			More Certain			Less Certain						
Year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Total Commitments	$25	$35	$0	$30	$40	$40	$40	$40	$50	$50	$50	$50	$50

Fund Projections

- **Red line** is the [5%] target private credit allocation based on projected plan total NAV; **Black dashed line** is the 1.5x over-commitment.
- Goal is to keep private credit NAV (**green bar**) plus uncalled capital commitments (**blue bar**), between red line and black dashed line.

Private Credit Plan Projections



	Actual			Projected									
Year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Private Credit NAV	$537	$513	$72	$108	$133	$145	$148	$158	$170	$179	$189	$198	$205
Uncalled Capital Commitments	$354	$276	$41	$29	$24	$26	$27	$27	$31	$33	$34	$34	$34
Private Credit NAV + Uncalled Capital Commitments	$891	$789	$113	$137	$157	$171	$175	$185	$202	$212	$223	$232	$239
Target Private Credit NAV	$335	$334	$278	$144	$149	$154	$159	$165	$171	$177	$183	$189	$196
Over-Commitment Pace	1.5x	1.5x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x	1.50x
Target Private Credit Over Allocation	$503	$502	$416	$215	$223	$231	$239	$247	$256	$265	$274	$284	$294
Beginning Plan NAV	$3,204	$3,350	$3,344	$2,776	$2,873	$2,974	$3,078	$3,186	$3,297	$3,412	$3,532	$3,655	$3,783
Yearly Return	$147	($6)	($568)	$97	$101	$104	$108	$111	$115	$119	$124	$128	$132
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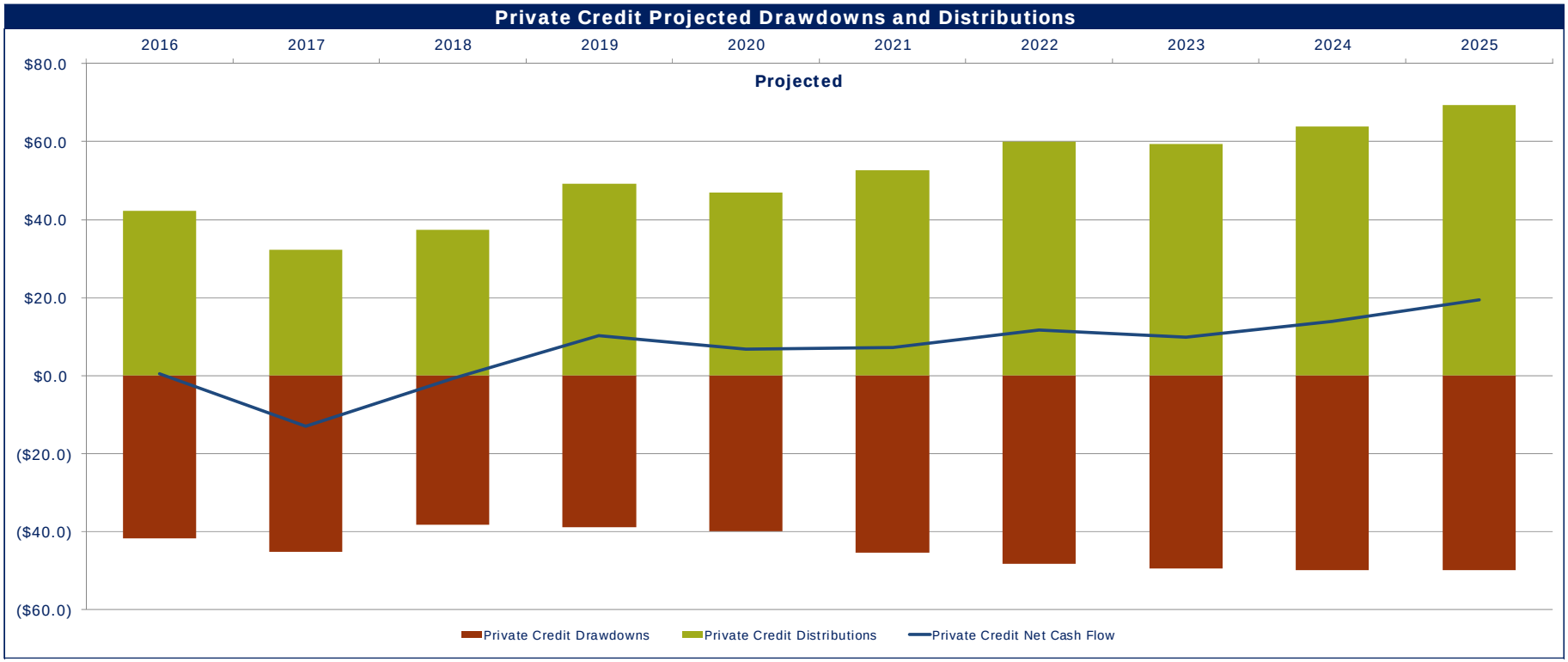
Private Credit Percent of Total Plan Assets													
Private Credit NAV	16.0%	15.3%	2.6%	3.8%	4.5%	4.7%	4.6%	4.8%	5.0%	5.1%	5.2%	5.2%	5.2%
Private Credit Uncalled Capital Commitments	10.6%	8.2%	1.5%	1.0%	0.8%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	0.9%	0.9%
NAV + Uncalled Capital Commitments	26.6%	23.6%	4.1%	4.8%	5.3%	5.6%	5.5%	5.6%	5.9%	6.0%	6.1%	6.1%	6.1%
Target Private Credit Allocation	10.0%	10.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

Private Credit Cash Flows



	Projected									
Year	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Private Credit Drawdowns	($42)	($45)	($38)	($39)	($40)	($45)	($48)	($49)	($50)	($50)
Private Credit Distributions	$42	$32	$37	$49	$47	$53	$60	$59	$64	$69
Private Credit Net Cash Flow	$1	($13)	($1)	$10	$7	$7	$12	$10	$14	$19

Disclaimers & Disclosures

- This report contains summary information regarding the investment management approaches described herein but is not a complete description of the investment objectives, policies or portfolio management and research that supports these approaches.
- Past performance is no guarantee of future results.
- The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.
- This report may contain confidential or proprietary information and may not be copied or redistributed to any party not legally entitled to receive it.

In addition, it is important that investors understand the following characteristics of non-traditional investment strategies including hedge funds, real estate and private equity:

1. Performance can be volatile and investors could lose all or a substantial portion of their investment.
2. Leverage and other speculative practices may increase the risk of loss.
3. Past performance may be revised due to the revaluation of investments.
4. These investments can be illiquid, and investors may be subject to lock-ups or lengthy redemption terms.
5. A secondary market may not be available for all funds, and any sales that occur may take place at a discount to value.
6. These funds are not subject to the same regulatory requirements as registered investment vehicles.
7. Managers may not be required to provide periodic pricing or valuation information to investors.
8. These funds may have complex tax structures and delays in distributing important tax information.
9. These funds often charge high fees.
10. Investment agreements often give the manager authority to trade in securities, markets or currencies that are not within the manager's realm of expertise or contemplated investment strategy.

Monroe Capital®

Innovative Capital Creating Value

Monroe Capital Private Credit Fund II LP

Board Presentation

Michael Egan, Chief Credit Officer
Zia Uddin, Portfolio Manager
R. Sean Duff, Managing Director

DALLAS POLICE & FIRE PENSION SYSTEM

Monroe Capital: Firm Overview

- **Monroe Capital, founded in 2004, provides private credit solutions to corporate borrowers in the U.S. and Canada**
  - Monroe Capital Management Advisors, LLC, an affiliate of Monroe Capital, LLC, is a SEC-registered investment adviser with approximately $3.3 billion of committed and managed capital (as of July 1, 2016)

- **Headquartered in Chicago, Monroe Capital has grown to a team of approximately 70 with 45 investment professionals**
  - Monroe management averages over 25 years of experience and owns 100% of the firm
  - Seven additional offices in Atlanta, Boston, Dallas, Los Angeles, New York, San Francisco and Toronto

- **Disciplined underwriting with a 12-year track record in direct lending**
  - "Credit First – Zero Loss" Mentality
  - Strong underwriting infrastructure with workout, turnaround and restructuring experience
  - Focus on downside protection: less than 0.17% cumulative historical loss ratio since 2002[1-3]

- **Differentiated Deal Sourcing Platform**
  - 17 senior origination professionals located in 8 offices in the U.S. and Canada
  - Deep industry relationships with banks, joint venture partners, intermediaries and service providers
  - Reputation for timely and efficient deal execution

- **Institutional and high net worth investor client base**
  - Limited Partners include various state and local pensions, corporate pensions, endowments & foundations, regional banks, family offices, sovereign wealth funds, etc.
  - Approved and recommended by multiple consulting firms

- **Proven Performance**
  - Since 2002, Monroe has originated, agented, underwritten and structured 200 deals; generating over a 14.1% unlevered gross IRR (as of March 30, 2016)[1-3]
  - During the crisis period of 2008-2009, Monroe's single operating vehicle, MC Funding, generated 25%+ net cash-on-cash returns per annum and made every scheduled quarterly distribution[1]

[1] Prior investment performance is not indicative of or a guarantee of future results. Please see important disclaimers at the back of this presentation.
[2] The selection criteria for track record is generally as follows: (i) senior and secured private loan investments; (ii) investments originated, agented, underwritten and structured by the partners of Monroe; (iii) club transactions with a small number of co-lending partners versus broadly syndicated transactions and/or (iv) directly originated opportunistic investments. These investments include investments that were executed by the senior management of Monroe while at their predecessor firm (Hilco Capital), as well as investments consummated by Monroe Capital Senior Secured Direct Loan Fund LP, Monroe Capital Partners Fund LP, Monroe Capital Partners Fund II LP and Monroe Capital Corporation for the period from January 2002 through September 30, 2015 that are indicative of Fund II's expected investments. The returns of this selected group of investments are provided for illustrative purposes only and do not reflect the returns of all investments made by the predecessor firm and the referenced Monroe advised funds, which returns may be materially different from the returns of this selected group.
[3] The gross investment performance referenced above is presented on a gross unlevered basis before the effects of leverage, management fees, "carried interest" or incentive fees, taxes and other fund expenses to which an investor in a Fund would be subject. Any future investor's return will be reduced by the advisory fees and other expenses that such investor may incur as a client of Monroe Capital Management Advisors, LLC. All such advisory fees of Monroe Capital Management Advisors, LLC are described in Part 2Aof its FormADV.

Monroe Capital

Monroe Capital: Senior Management and Investment Committee

Theodore Koenig
Chief Executive Officer & President
Year joined: 2004

- 32 years of transactional / credit experience
- Hilco Capital; Holleb & Coff; Winston & Strawn
- B.S. Accounting w/high honors - Kelley School of Business at Indiana University
- J.D. – Chicago-Kent College of Law

Michael Egan
Chief Credit Officer
Year joined: 2004

- 32 years of credit/ workout experience
- Hilco Capital; CIT Group; The National Community Bank of New Jersey; Key Corp.
- B.S. Business Management – Ithaca College School of Business

Tom Aronson
Head of Originations
Year joined: 2004

- 32 years of credit/ origination experience
- Hilco Capital; Cole Taylor Bank; Barton Chemical Corp; American National Bank
- B.S. Finance and Marketing – Indiana University
- M.B.A. Management Accounting – DePaul University

Carey Davidson
Head of Capital Markets
Year joined: 2015

- 17 years of middle market lending experience
- Carlyle Group; Churchill Financial
- B.A. Communications– The University of Wisconsin - Madison
- M.B.A.– University of Chicago Booth School of Business

Zia Uddin, CFA
Portfolio Manager: Private Credit Fund Vehicles
Year joined: 2007

- 23 years of private equity/consulting experience
- Franklin Street Partners; Arthur Andersen
- B.S. Finance – University of Illinois at Urbana-Champaign
- M.B.A. Finance and Econometrics – University of Chicago

Aaron Peck
Portfolio Manager: BDC and Opportunistic Credit Vehicles
Year joined: 2012

- 23 years of credit/finance experience
- Deerfield Capital; ESL; Black Diamond Capital
- B.S. Commerce – University of Virginia
- M.B.A. Finance w/honors – University of Chicago

Jeremy VanDerMeid
Portfolio Manager: CLO Vehicles
Year joined: 2007

- 18 years of credit/finance experience
- Morgan Stanley; GE Capital; Heller Financial
- B.B.A. – Ross School of Business at University of Michigan
- M.B.A. – Northwestern University

Alex Franky
Head of Direct Underwriting
Year joined: 2004

- 24 years of lending experience
- Hilco Capital; LaSalle Bank; GMAC Business Credit
- B.S. Accounting – University of Illinois at Chicago
- M.B.A. Finance and International business – Loyola University

Monroe Capital

Monroe Capital: Origination Team – Geographic, Industry and Vertical Focused

GEOGRAPHIC FOCUS

Jeffrey Kolke
CHICAGO

- 26 years of credit and lending exp.
- GE Capital
- M.B.A. – Wayne State
- Midwest Focus

Lee Stern
NEW YORK

- 37 years of credit and lending exp.
- Levine Leichtman
- KKR
- Blackstone/GSO
- M.B.A – UPENN
- Northeast Focus

Ben Marzouk
NEW YORK

- 33 years of credit and lending exp.
- Praesidian Capital
- Credit Mkt. Adv.
- CIT Group
- M.B.A. – Emory
- Northeast Focus

Joe Rodgers
ATLANTA

- 25 years of investment banking, consulting and lending exp.
- KPMG
- Eve Partners
- Cerberus Capital Management

Mark Sturrock
CANADA

- 31 years of credit and lending exp.
- Salus Capital Partners
- Canadian Imperial Bank of Commerce
- Wells Fargo Foothill Canada
- Royal Bank of Canada

Steve Hinrichs
CALIFORNIA

- 25 years of financing solution experience
- Capital One Business Credit
- Bank of America Business Capital
- General Electric Capital Corporation

Marc Adelson
NEW YORK

- 34 years of credit and lending exp.
- Medallion Financial Corporation

INDUSTRY / VERTICAL FOCUS

Glenn Flinn
HEALTHCARE

- Dallas Office
- 31 years of healthcare / credit exp.
- CapitalSource
- Heller / GE Capital
- M.B.A. - Texas

Matthew Evans
HEALTHCARE

- Chicago Office
- 17 years of credit exp. in healthcare
- Madison Capital
- Merrill Lynch
- M.B.A. - Northwestern

Patrick White
TECHNOLOGY

- San Francisco Office
- 19 years of technology/credit exp.
- H.I.G.
- American Capital
- Houlihan Lokey

Mark Solovy
TECHNOLOGY

- Chicago Office
- 19 years of technology / private equity exp.
- Hercules Technology
- J.D. – University of Pennsylvania

Andy Cozewith
MEDIA

- Atlanta Office
- 21 years of technology / private equity exp.
- SunTrust
- CIT / GE Capital
- M.B.A - Fordham

Jeremy Simmons
DIRECT

- Chicago Office
- 9 years of business development / inv. banking exp.
- Allied Business Group
- M.B.A. - Kansas

Sean Cahill
DIRECT - HEALTHCARE

- Chicago Office
- 4 years of wealth management exp.
- Capstone Financial Advisors
- Clune & Associates

Andy Moser
RETAIL/ABL*

- Boston Office
- 26 years of commercial finance, ABL and retail industry exp.
- Salus Capital Partners

Marc Price
RETAIL/ABL*

- Boston Office
- 22 years of financial services, ABL exp.
- Salus Capital Partners
- EMCC, Inc.
- State Street Global Advisors

* Retail and Consumer Products Asset Based Lending

Monroe Capital

Monroe Capital: Portfolio Management and Underwriting Team

Alex Franky
Head of Direct Underwriting

- 24 years of lending experience
- Hilco Capital
- LaSalle Bank
- GMAC Business Credit
- M.B.A. - Loyola

Jeffrey Williams
Managing Director & Head of Syndicated Underwriting

- 17 years of finance experience
- LEK Consulting
- Lehman Brothers
- M.B.A. – University of Chicago

Gerry Burrows
Managing Director

- 19 years of middle market credit exp.
- Roynat Capital
- Tri West Capital
- Century Capital
- Prudential Securities

Jeffrey Cupples
Managing Director

- 12 years of middle market credit exp.
- Pangaea Asset Management
- LaSalle Bank

Brian Kennedy
Director

- 21 years of asset based lending, structured finance exp.
- Salus Capital
- Wells Fargo
- M.B.A. – Babson College

Matthew Lane
Managing Director

- 18 years of credit /investment exp.
- Freeport Financial LLP
- Merrill Lynch Capital
- Heller Financial

Michael Meyer
Director

- 21 years of finance/investment banking exp.
- Monroe Credit Advisors
- Merrill Lynch
- M.B.A. - DePaul

Kyle Asher
Director

- 8 years of PE/ middle market credit exp.
- Calder Capital
- Mindshare Capital
- M.B.A. - Northwestern

Nathan Harrell
Director

- 11 years of middle market credit exp.
- Deerfield Capital
- Pangaea Asset Management

Mark Gallivan
Asst Vice President

- 5 years of finance exp.
- Salus Capital Partners

Chris Lund
Asst Vice President

- 7 years of leveraged finance exp.
- Sankaty Advisors

Rob Tanakatsubo
Vice President

- 9 years of comm. lending and structured finance exp.
- Fifth Third Bank
- MB Financial Bank

Jack Bernstein
Asst. Vice President

- 4 years of financial service exp.
- HIG Capital
- Deutsche Bank

Chris Enas
Asst. Vice President

- 6 years of credit /finance exp.
- Denali Capital
- Business Appraisal Services, LLC

Bart Ginocchio
Senior Associate

- 4 years of finance exp.
- Fifth Third Bank

Matt Glassman
Associate

- 2 years of middle market credit exp.

Will Hasten
Asst. Vice President

- 6 years of finance exp.
- U.S. Bank
- M.B.A. – University of Chicago (exp. 2017)

Jacob Neuberger
Asst. Vice President

- 3 years of finance exp.
- Pricewaterhouse Coopers
- M.B.A. - Indiana

Alex Parmacek
Asst. Vice President

- 4 years of commercial lending and structured finance exp.
- Wells Fargo, N.A.

Jordan Stephani
Asst. Vice President

- 4 years of middle market credit exp.

Monroe Capital

Monroe Capital: Committed and Invested AUM of $3.3B[1]

	INSTITUTIONAL VEHICLES AUM = $2,104 MILLION[1]		LISTED and PRIVATE CAPITAL VEHICLES AUM = $345 MILLION[1]		CLO VEHICLES AUM = $874 MILLION[1]	
SBIC	**Monroe Capital Partners Fund I LP ($101M, 2011)** **Monroe Capital Partners Fund II LP ($19M, 2014)**	• $305 million invested assets • Unitranche and junior • Directly originated			**MC Funding Ltd. (2006)** **Past Reinvestment Period** **$409M CLO**	• $11 million fund • Senior secured traditional middle market loans • Top-Decile CLO Manager[2]
SINGLE FUNDS	**Monroe FCM Direct Loan Fund LP** **($30M, 2014)** **Monroe Private Credit Fund A LP ($450M, 2015)**	• $524 million invested assets • Senior secured and unitranche • Directly originated	**Monroe Capital Corporation** **NASDAQ: MRCC**	• $345 million invested assets • Unitranche, senior secured, junior and mezzanine • Directly originated focus • 100% invested	**Monroe Capital CLO 2014-1, Ltd. (2013)** **$358M CLO**	• $353 million fund • Senior secured traditional middle market loans • Exposure to directly originated Monroe loans
INSTITUTIONAL PRIVATE CREDIT	**Monroe Capital Senior Secured Direct Loan Fund LP** **($500M, 2013)**	• $686 million invested assets • Senior secured, unitranche and opportunistic • Directly originated	**Monroe Capital Income Plus Fund LP** **(Fundraising)**	• Launching 2016 • Middle Market, Opportunistic, Specialty Finance	**Monroe Capital BSL CLO 2015-1, Ltd.** **(2014)** **$412M CLO**	• $365 million fund • Broadly syndicated loans • Senior secured traditional middle market
	Monroe Capital Private Credit Fund II LP **(est. $850M, Fundraising)**	• $589 million invested assets • Senior secured, unitranche and opportunistic • Directly originated	**Monroe Capital Insurance Dedicated Fund (Fundraising)**	• Launching 2016 • Middle Market, Opportunistic, Specialty Finance	**Monroe Capital MML CLO 2016-1, Ltd.** **(2015)** **$305M CLO**	• $145 million fund • Senior secured traditional middle market • Broadly syndicated loans
	Monroe Capital Opportunistic Private Credit Fund LP **($500M, Fundraising)**	• Launching 2016 • Middle Market, Opportunistic, Specialty Finance				

[1] Committed and Invested Assets as of July 1, 2016
[2] January 2011 Citibank CLO Study based on 21.8% return through December 2010
Data may differ insignificantly due to rounding.

Monroe Capital: Reasons to Invest in Private Credit

HIGH ABSOLUTE RETURNS	RISK DIVERSIFIER	INCREMENTAL YIELDS	CONTRACTUAL CASH FLOWS	ATTRACTIVE RISK/RETURN PROFILE	INTEREST RATE HEDGE
Has historically **performed well** throughout **various economic environments** and is **largely uncorrelated** with traditional asset classes	Senior loans are at the top of the capital structure with a **senior-lien on assets** and often a pledge of company stock	Senior secured loan positions generally provide a **higher level of safety** and **lower volatility** than junior debt, mezzanine or equity	Returns predominantly based on contractual **current income** (coupon, fees and appreciation in warrants and stock); **minimizes any J-curve effect**	**Lower default** rates and **higher recovery rates** in middle market senior secured loans	Structured as floating interest rates over LIBOR (with a floor) to **protect and provide a hedge against rising interest rates**

Monroe Capital leverages its extensive private credit platform to generate differentiated returns as compared with the traditional Fixed Income markets.

Fixed Income Benchmarks[1]	1-YR	3-YR	5-YR
Credit Suisse Leveraged Loan Index	**0.93%**	**3.04%**	**4.00%**
S&P/LSTA US Leveraged Loan Index	**2.71%**	**2.29%**	**3.77%**
Barclays Aggregate Bond Index	**5.49%**	**4.09%**	**3.33%**

[1] Credit Suisse Leveraged Loan Index, S&P/LSTA U.S. LEVERAGED LOAN 100 INDEX and Barclays US Aggregate Bond TR USD. As of 6/30/16. Investors are not able to invest directly in the indices referenced in this illustration and unmanaged index returns do not reflect any fees, expenses or sales charges. The referenced indices are shown for general market comparisons and are not meant to represent an investment.

Monroe Capital: Firm Capabilities

Monroe's focus is specializing in the lower to traditional middle market:

Lower Middle Market <$25M EBITDA	Traditional Middle Market $25M - $100M EBITDA
▪ Niche finance companies with limited geographic reach/resources ▪ Limited competition: regional banks have exited the market ▪ Sponsored and non-sponsored deals ▪ Higher pricing, opportunity for equity upside and more conservative structures ▪ Full covenant packages ▪ Pricing: L+600-1000bps+	▪ Finance Companies, Private Funds and BDCs ▪ Moderately competitive ▪ Largely sponsored deals ▪ Follows trends in Broadly Syndicated Market ▪ Competitive pricing: minimal opportunistic pricing and equity upside ▪ Moderate covenants ▪ Pricing: L+350-600bps
Monroe believes this segment is most underserved and provides the best risk/return versus other equity and fixed income markets	

- **Monroe is continuously selected by borrowers for its:**
  - Ability to act timely
  - Efficient deal process
  - Certainty of closing
  - Extensive lower middle market experience
- **Monroe reviews approximately 1,700+ transactions per year**
  - Sponsor vs. Non-Sponsor deal flow has historically been 65/35
  - 17 Originators based throughout North America provide diverse geographic and industry vertical specific deal flow
- **Highly selective underwriting process results in less than 2% of total deals reviewed, executing 40-60 transactions**

Monroe Capital: Objective and Portfolio Composition

- **Senior Secured Direct Loans Originated by Monroe Capital**
  - Focused on lower middle market companies with less than $25 million in EBITDA
  - Opportunity to increase yield through Unitranche structure
  - U.S. focused borrowers
  - Diverse across multiple industries and regions
  - Focus on both private equity sponsored and non-sponsored borrowers

- **Secondary (Club) Senior Loans**
  - Ability to purchase attractive club transactions in the lower and traditional middle market
  - Senior secured positions

- **Other Private Credit Investments**
  - Opportunistic private credit investments
  - Market-based transactions
  - Stressed and distressed sellers of private credit investments
  - Securitizations, asset-based lending, and junior debt

Fund	Portfolio Composition	All-in Coupon	Total Net Unlevered Return[1]	Total Net Levered Return[1]
Senior Loans	80-100%	7-10%	8-10%	12-14%
Senior (Direct)	50%+	7-9%	8-10%	12-14%
Unitranche (Direct)	0-40%	8-10%	10-12%	13-15%
Senior Loans (Secondary)	0-15%	7-10%	8-10%	12-14%
Other Private Credit	0-20%	-	+11%	+13%
TOTAL PORTFOLIO	**100%**		**8-10%**	**12-14%**

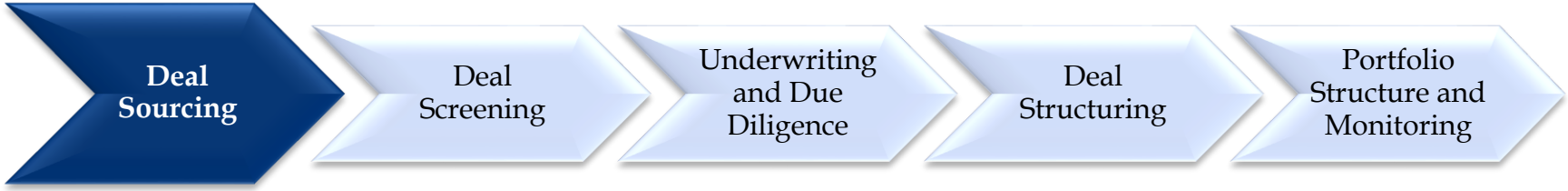
[1] Target returns are shown as a potential estimate of returns, leverage of 0.5-1:1 and not a guarantee of future returns
Please see important disclaimers at the back of this presentation.

Monroe Capital: Investment Approach - Breakdown of Target Returns[1]

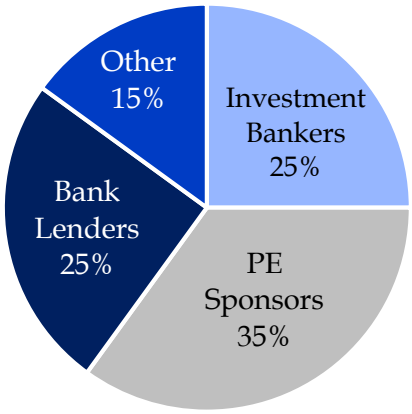
All-in Contractual Coupon (Payable quarterly on an annual basis and includes LIBOR Floor)	**6-10%+**	*Gross Transactional Returns*
Fees[2] (one-time, not annualized, payable quarterly)	**2-4%**	
Warrants / Equity Upside (one-time, not annualized)	**2-5%+**	
Total NET Unlevered Return[4]	**8-10%+**	*Net Investor Target Returns[4]*
Total NET Levered Return[3,4]	**12-14%+**	

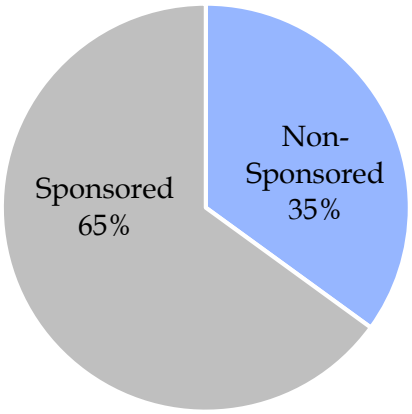
[1] All target returns on this page are provided for illustrative purposes only, based on current market conditions, onshore investors and historical performance and are neither a guarantee nor a projection of future returns. Please see important disclaimers at the back of this presentation.
[2] Prepayment, success, covenant waiver fees, etc.
[3] Leverage of 0.5-1:1 estimated
[4] Target NET returns are shown after anticipated effects of leverage (if levered), management fees, "carried interest" and other fund expenses, and are neither a guarantee nor a projection of future returns. Please see important disclaimers at the back of this presentation.

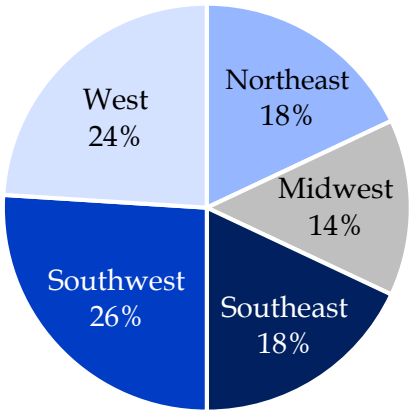
Monroe Capital: Investment Process - Differentiated Sourcing Capabilities



- **An average of 1,700+ transactions reviewed per year**
  - 50% from lower middle market direct opportunities
  - 50% from traditional middle market club and syndicated opportunities
- **Efforts are focused on different referral sources depending on the economic cycle**
- **Private equity sponsors, regional bank, and investment bank focus**
- **Non-private equity sponsored sourcing network, capabilities and expertise**







Monroe Capital: Investment Process - Deal Screening Characteristics

Deal Sourcing → **Deal Screening** → Underwriting and Due Diligence → Deal Structuring → Portfolio Structure and Monitoring

Company Size

- Lower middle market focus
- Revenue typically between $25 and $250 million
- EBITDA typically between $3 and $25 million
- Stable historical earnings and strong recurring cash flow
- Defendable market position and importance to customers

Geography / Industry

- Primarily U.S. based, diversified across multiple regions
- Focused across a diverse industry spectrum with less emphasis on real estate, venture, start-ups, minerals and agriculture
- Low cyclicality businesses

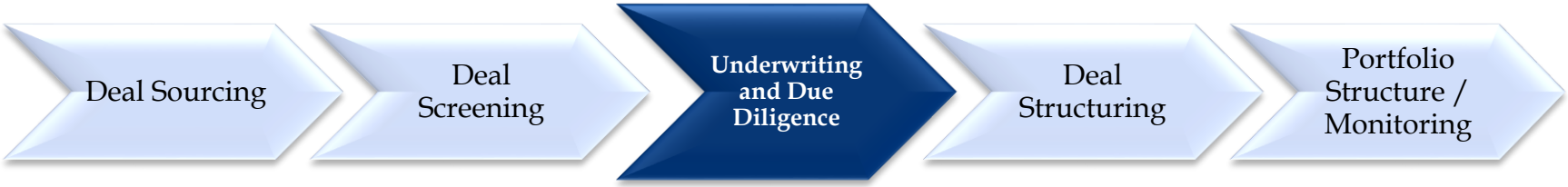
Investment Type

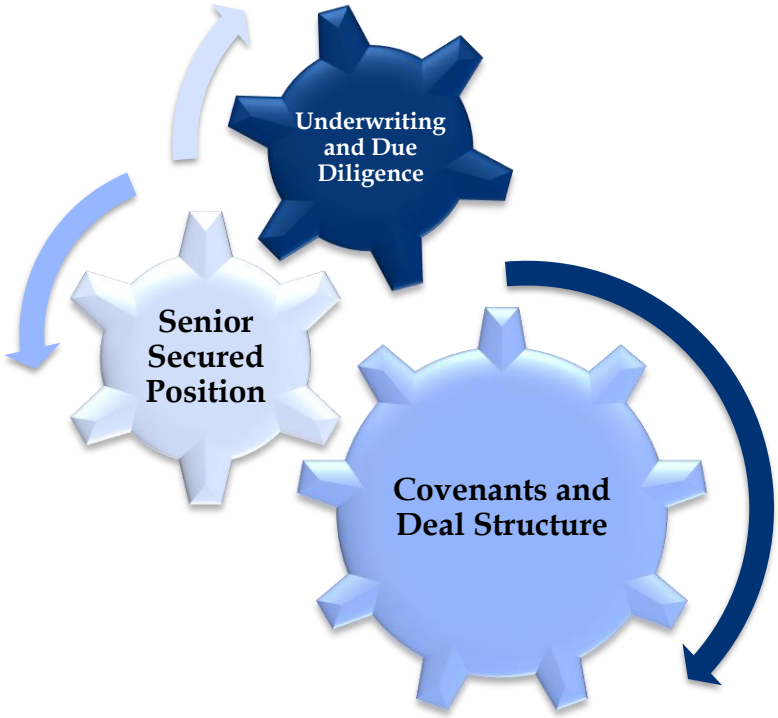
- Directly originated senior secured loans
- First lien, unitranche, last-out and bifurcated loans, and second liens
- Traditional middle market club loans
- Opportunistic private credit investments

Transactional Structure

- Generally less than 60% loan-to-value on average
- Target leverage multiple of 3.0 to 4.5 times EBITDA through Monroe's tranche of debt on average
- Floating Rate with a LIBOR floor
- 4-5 year in contractual maturities

Monroe Capital: Investment Process - Underwriting is key for "Credit First – Zero Loss" Mentality





- **Quality of Earnings Analysis**
  - Verification of EBITDA for TTM periods and preceding years
  - Often performed by third-party accounting firms with guidance from Monroe
- **Market Study / Business Review**
  - Evaluate borrower's business strategy and market conditions
- **Valuation Assessment**
- **Financial Modeling / Sensitivity Analysis**
  - Isolate core drivers of business / Perform downside scenarios
- **Customer and Client Calls / Management Background Checks**
- **Management and onsite meetings**
- **Collateral Appraisals and Asset Verification**
- **Legal and Environmental Reviews**

Monroe Capital: Fund I - Investment Performance[1]

	Net Cumulative IRR[2]	Annualized Net Investment Income[2,3]	Annualized Cash on Cash Return[4]
Monroe Capital Senior Secured Direct Loan Fund LP	14.15%	17.34%	16.26%
Monroe Capital Senior Secured Direct Loan Fund (Unleveraged) LP	8.55%	10.56%	9.99%

As of March 31, 2016

[1] Prior investment performance is not indicative of or a guarantee of future returns. Please see important disclaimers at the back of this presentation.

[2] Calculated based on GAAP

[3] Annualized Q1 16 net investment income to limited partners

[4] Based on actual cash distribution to investors for period from first close to March 31, 2016

Monroe Capital: Private Credit Fund II LP Stated Terms[1]

Name of Funds	• Monroe Capital Private Credit Fund II LP • Monroe Capital Private Credit Fund II (Unleveraged) LP
Management Fee	1.0% on invested assets
Carried Interest	10%
Preferred Return	• 7% for Monroe Capital Private Credit Fund II LP • 5% for Monroe Capital Private Credit Fund (Unleveraged) LP
Fund Investment Period	4 years beginning on the "Final Close" of the Fund
Quarterly Distributions	Interest and fees distributed
Fund Life	6 years with the option of two one-year extensions
Target Capital Raise	$600 million
Hard Cap on Capital Raise	$850 million

Appendix

Monroe Capital: Performance Highlights – All Funds Track Record

Investment Vehicles	Fund Vehicle	Net Cumulative IRR[1]	Annualized Cash-on-Cash[2]
Private Credit Funds	Monroe Capital Partners Fund I LP (2011)	18.6%	16.6%
	Monroe Capital Partners Fund II LP (2014)	13.3%	10.3%
	Monroe FCM Direct Loan Fund LP (2012)	9.2%	8.3%
	Monroe Private Credit Fund A LP (2015)	11.6%	11.2%
	Monroe Capital Senior Secured Direct Loan Fund LP (2014)	14.2%	16.3%
	Monroe Capital Private Credit Fund II LP (2016)	n/a	n/a
Public BDC	Monroe Capital Corporation (NASDAQ: MRCC) (2012)	33.9%[3]	9.6%[4]
CLO Vehicles	MC Funding Ltd. (2006)	-	22.4%
	Monroe Capital CLO 2014-1, Ltd.	-	18.1%
	Monroe Capital BSL CLO 2015-1, Ltd.	-	16.5%
	Monroe Capital MML CLO 2016-1 Ltd.	-	n/a

[1] Monroe Capital Partners Fund LP / Monroe FCM Direct Loan Fund LP / Monroe Capital Senior Secured Direct Loan Fund LP – Cumulative Net IRR (ending limited partners' balances calculated in accordance with GAAP).
[2]The return figures are current as of the date hereof and may decrease in the future. MC Funding Ltd. and MC Capital CLO 2014-1, Ltd. - Net annual cash-on-cash (pre-tax) return to equity holders in MC Funding LTD. MC Funding return is through June 2016. MC Capital CLO 2014-1 return is through April 2016. Monroe Capital BSL CLO 2015-1 is through May 2016.
[3]Total return based on net asset value is calculated by dividing the cumulative net increase in net assets from operations per share by the net asset value per share at inception. Total return is not annualized.
[4]Market yield based on current annualized dividend divided by the share price of MRCC as of 3/31/16

Monroe Capital: MC Funding Ltd. Investment Track Record[4]

A $409 million closed-end fund (CLO) launched in December 2006 that is focused on traditional middle market loans

	Q1	Q2	Q3	Q4	Net Cash-on-Cash Return[1]
2007		0.80%	3.95%	5.21%	13.28%[2]
2008	6.00%	8.82%	5.53%	4.86%	25.20%
2009	7.86%	5.03%	6.68%	6.22%	25.79%
2010	6.49%	5.41%	6.98%	7.17%	26.06%
2011	7.68%	9.48%	8.77%	8.61%	34.53%
2012	7.34%[3]	8.76%[3]	7.77%[3]	5.40%[3]	23.86%[3]
2013	4.29%[3]	4.27%[3]	4.61%[3]	4.72%[3]	17.89%[3]
2014	4.46%[3]	3.03%[3]	2.57%[3]	2.18%[3]	12.24%[3]
2015	1.63%[3]	1.32%[3]	0.93%[3]	0.91%[3]	4.79%[3,5]

Fund Highlights:

- 20.6% net cash-on-cash return to equity from inception December 2006 through December 2015
- Never missed a quarterly cash distribution to investors
- Distributed over 25% of net cash-on-cash distributions per annum to investors during the financial crisis in both 2008 and 2009

1 Based on net cash-on-cash return (pre-tax) to equity holders in MC Funding Ltd. The return figures are current as of the date hereof and may decrease in the future.
2 During ramp-period.
3 All returns after December 19, 2011 are post the CLO's Reinvestment Period.
4 Prior investment performance is not indicative of or a guarantee of future returns.
5 Extrapolated annualized figure.

Monroe Capital: Monroe Capital Partners Fund LP Investment Track Record[1]

Monroe Capital Partners Fund LP (SBIC) - $251 million closed-end fund launched in February 2011

Performance Statistics[1]	
Net Cumulative IRR[2]	20.0%
Inception to Date Annualized Net Cash-on-Cash Return[3]	18.0%

Fund Highlights

- **Diversity:** Invested in 26 distinct borrowers – all loans agented by Monroe
  - Average all-in effective rate: 11.7%
  - Average closing fee: 2.4%
- **Security:** Most investments are in secured debt (unitranche) structures
- **Velocity:** Approximately 85% invested
- **Realizations**: 15 realized transactions thus far in the portfolio

As of September 30, 2015.
1 Prior investment performance is not indicative of or a guarantee of future returns. Please see important disclaimers at the back of this presentation.
2 Calculated based on GAAP.
3 Net cash-on-cash returns are calculated based on actual distributions net of fees and expenses from first close to September 30, 2015.
The Small Business Administration's ("SBA") small business investment company ("SBIC") Debenture program enables qualifying funds to obtain investment dollars from the SBA, providing Limited Partners with enhanced returns with 2:1 non-recourse matching funds.

Monroe Capital: Directly Originated Private Loan Transactions: Investment Track Record[3]

- **Monroe's senior management have collectively participated in over $15 billion of private loan investments during their careers**
  - 200 of the approximate 500 past transactions executed by Monroe's senior management are originated, agented, underwritten and structured by the partners of Monroe *(as of March 31, 2016)*[1]
- **From 2002 to present, they have invested approximately $3.4 billion in 200 directly originated private loan transactions generating over a 14.1% unlevered gross IRR** ***(as of March 31, 2016)***[2,3]
- **Focus on downside protection:** ***less than 0.17% cumulative historical loss ratio since 2002***
  - Recoveries on four losses range from approximately 41-98%

Senior Secured Loan Investment Track Record [1]		
	Number of Investments ($)	Unlevered Gross IRR
Realized	100 ($1,003 million)	16.7%
Unrealized	100 ($2,239 million)	11.5%
Total	200 ($3,242 million)	14.2%

[1] The selection criteria for track record is generally as follows: (i) senior and secured private loan investments; (ii) investments originated, agented, underwritten and structured by the partners of Monroe; (iii) club transactions with a small number of co-lending partners versus broadly syndicated transactions and/or (iv) directly originated opportunistic investments. These investments include investments that were executed by the senior management of Monroe while at their predecessor firm (Hilco Capital), as well as investments consummated by Monroe Capital Senior Secured Direct Loan Fund LP, Monroe Capital Partners Fund LP, Monroe Capital Partners Fund II LP and Monroe Capital Corporation for the period from January 2002 through September 30, 2015 that are indicative of Fund II's expected investments. The returns of this selected group of investments are provided for illustrative purposes only and do not reflect the returns of all investments made by the predecessor firm and the referenced Monroe advised funds, which returns may be materially different from the returns of this selected group.
[2] The gross investment performance referenced above is presented on a gross unlevered basis before the effects of leverage, management fees, "carried interest" or incentive fees, taxes and other fund expenses to which an investor in a Fund would be subject. Any future investor's return will be reduced by the advisory fees and other expenses that such investor may incur as a client of Monroe Capital Management Advisors, LLC. All such advisory fees of Monroe Capital Management Advisors, LLC are described in Part 2A of its Form ADV.
[3] Past investment performance is not indicative of or a guarantee of future returns. Please see important disclaimers at the back of this presentation.

Monroe Capital: Fund I - Current Portfolio Update[1]

	WEIGHTED AVERAGE[1,2]	LOW	HIGH
TRANSACTION SIZE[5]:	$60.9	$10.0	$270.0
FUNDED INVESTMENT:	$13.4	$2.4	$40.1
EBITDA OF COMPANY:	$16.0	$2.5	$143.0
ALL-IN COUPON[3]:	9.7%	6.5%	14.3%
CLOSING FEE:	2.0%	1.0%	2.8%
LEVERAGE MULTIPLE[4] (Current):	3.8x	0.7x	6.2x
LEVERAGE MULTIPLE[4] (At Close):	3.8x	1.1x	5.7x
LOAN TO VALUE (Current):	56.5%	18.0%	100.7%
LOAN TO VALUE (At Close):	53.5%	23.9%	70.0%

- **11 of the 45 transactions do not have a private equity sponsor (non-sponsored)**
  - Additional upside sought through the use of warrants, success fees and equity co-investments

WARRANTS	EQUITY	PREFERRED STOCK	COMMON
2	2	2	1

1 As of June 30, 2016.
2 Weighted Average based on consolidated portfolio holding sizes.
3 All-in Coupon is the actual effective rate that the borrower pays, inclusive of LIBOR floor, contractual rate, and other recurring fees.
4 Leverage Multiple is calculated based on Monroe's tranche of debt versus the EBITDA of the company. Loan to Value is calculated based on Monroe's tranche of debt versus Enterprise Value. All-in coupon does not include closing fees.
5 Total global deal size.
Note: The top table does not include the Fund's investments in a CLO or an ABL transaction as they are measured utilizing different metrics.

Monroe Capital: Snapshot - Monroe Capital Private Credit Fund II LP

	WEIGHTED AVERAGE[1,2]	LOW	HIGH
TRANSACTION SIZE[5]:	$72.0	$10.0	$280.0
FUNDED INVESTMENT:	$12.8	$2.7	$31.1
EBITDA OF COMPANY:	$20.1	$0.2	$64.2
ALL-IN COUPON[3]:	8.6%	4.8%	15.0%
CLOSING FEE:	1.6%	1.0%	2.5%
LEVERAGE MULTIPLE[4] (Current):	3.6x	0.7x	5.0x
LEVERAGE MULTIPLE[4] (At Close):	3.7x	0.6x	5.3x
LOAN TO VALUE (Current):	47.0%	14.6%	69.2%
LOAN TO VALUE (At Close):	48.2%	9.7%	69.2%

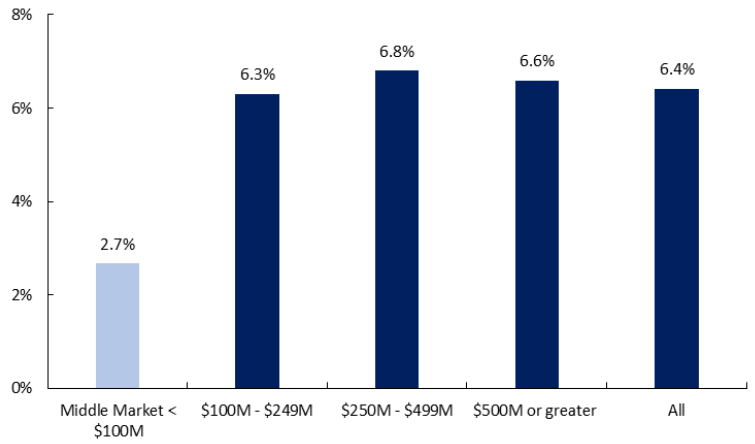
- **2 of the 32 transactions does not have a private equity sponsor (non-sponsored)**
  - Additional upside sought through the use of warrants and equity co-investments

WARRANTS	EQUITY
1	3

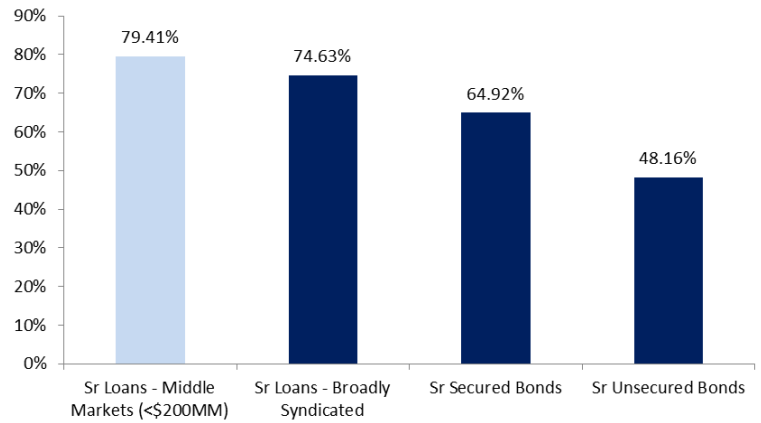
1 As of June 30, 2016
2 Weighted Average based on consolidated portfolio holding sizes.
3 All-in Coupon is the actual effective rate that the borrower pays, inclusive of LIBOR floor, contractual rate, and other recurring fees.
4 Leverage Multiple is calculated based on Monroe's tranche of debt versus the EBITDA of the company. Loan to Value is calculated based on Monroe's tranche of debt versus Enterprise Value. All-in coupon does not include closing fees.
5 Total global deal size.
Note: The top table does not include the Fund's opportunistic investments in equities or a CLO as they are measured utilizing different metrics.

Monroe Capital: Industry Default and Recovery Rates by Loan Class

Average Default Rates by Loan Size
(S&P LCD, 1995 to 2014)



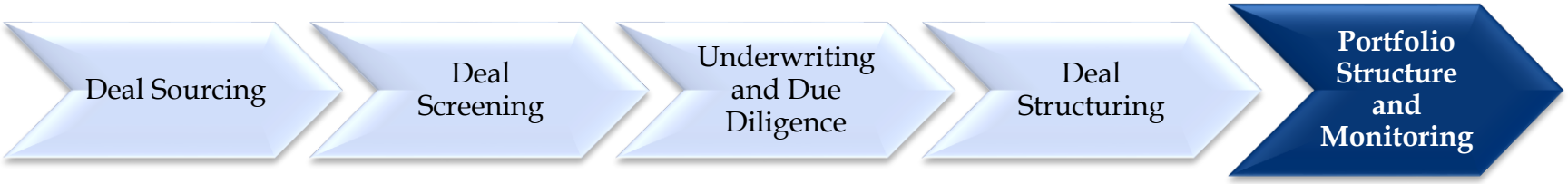
Average Recovery Rates by Type
(S&P Capital IQ, 1989 to 2014)



Middle Market Loans have Lower Defaults and Higher Recoveries

- **Conservative structure of middle market loans, typically lower multiples and LTV**
- **Loans are typically held by the originator or a small lending group**
- **Customized covenant and default provisions tailored to suit individual borrowers**
- **Ability to act quickly due to heightened oversight and monitoring and direct access to borrowers**

Monroe Capital: Investment Process - Monthly Trend Card Monitoring



- **Standardized process for monitoring portfolio companies**
  - Developed over a 15 year period across multiple business and economic cycles
- **"Trend Card" analysis of "key drivers" of performance on a monthly basis**
  - Proprietary and customized analytics for each portfolio company investment
- **Regular internal meetings for comprehensive discussion of all portfolio investments**
  - Monthly portfolio reviews with investment committee and portfolio account managers
- **Internal credit ratings are generated to each portfolio investment**
  - Ratings assigned between 1 and 5 (1 being the best) at monthly portfolio review and will determine corrective action, if necessary *(please see Appendix for internal credit rating definitions)*

Monroe Capital: Fund I - Internal Credit Rating Summary and Rating Description

Deal	Internal Credit Rating[1]
360 Holdings III Corp.	2
AIM Aerospace, Inc.	2
American Community Homes, Inc.	2
American Mortgage Consultants, Inc.	2
Ashley Stewart Holdings, Inc.	2
BCC Software	2
Benton-Georgia, LLC	4
Cal Net Enterprises LLC	2
Confie Seguros Holdings II Co.	2
Cornerstone Detention Products, Inc.	3
Cyalume Technologies Holdings, Inc.	2
Data Physics Corporation	3
Diesel Direct Holdings Inc.	2
Employee Benefit Solutions	2
Education Corporation of America	2
EPIC Holdings Inc.	2
Fineline Technologies	2
Frugal MacDoogal	2
Gem Shopping Network, Inc.	3
Healthtronics, Inc.	2
Histopathology Services, LLC	2
Incipio Technologies, Inc.	2
Intelius, Inc.	2

Deal	Internal Credit Rating[1]
Interior Logic Holdings, LLC	2
IPS	2
L.A.R.K. Technologies	2
Landpoint, LLC	2
Luxury Optical Holdings Co.	2
Miles Media, LLC	2
BSL CLO	N/A
Nelbud Services Group, Inc.	2
Omni Logistics, Inc.	2
OnCourse Learning Corporation	2
Output Services Group, Inc.	2
Precision Toxicology, LLC	2
PSBU Midco S.A.R.L.	2
Pure Barre, LLC	2
R&D Circuits	2
SCP TPZ Acquisition (Touch Tunes)	2
SHI Holdings, Inc.	3
Smiles Dental Holdings, LLC	3
SNI Companies	2
TRG, LLC	2
Trident University International, LLC	2
Yandy Holding, LLC	2

1 – Exhibiting the least amount of risk in our portfolio. Performing above expectations or the issuer's operating trends and risk factors are generally positive.

2 – Exhibiting an acceptable level of risk that is similar to the risk at the time of origination. Generally performing as expected or the risk factors are neutral to positive.

3 – Performing below expectations and indicates that the investment's risk has increased somewhat since origination. May be out of compliance with debt covenants; however, scheduled loan payments are generally not past due.

4 – Performing materially below expectations and indicates that the issuer's risk has increased materially since origination. Generally out of compliance with debt covenants, scheduled loan payments may be past due (but generally not more than six months past due).

5 – Performing substantially below expectations and the investment risk has substantially increased since origination. Most or all of the debt covenants are out of compliance or payments are substantially delinquent. Investments graded 5 are not anticipated to be repaid in full and we will reduce the fair market value of the loan to the amount we expect to recover.

1 Credit rating as of June 30, 2016
Fund I – Monroe Capital Senior Secured Direct Loan Fund LP, the predecessor fund to Monroe Capital Private Credit Fund II LP

Monroe Capital: Fund II - Internal Credit Rating Summary and Rating Description

Deal	Internal Credit Rating[1]
Alloy Wheel Repair Specialists, LLC	2
API Technologies Corp.	2
Argyle Executive Forum, LLC	2
Ashley Stewart Holdings, Inc.	2
Avadyne Health Holdings, Inc.	2
Cali Bamboo, LLC	2
Channel Partners Funding I LLC	2
Education Corporation of America	2
EMSI Holdco, Inc.	3
EPIC Holdings, Inc.	2
Familia Dental Group Holdings, Inc.	2
G&M OPCO LLC	2
Healthtronics, Inc.	2
High Performance Holdings, Inc.	2
Histopathology Services, LLC	2
InMobi Pte, Ltd.	2
Interior Logic Holdings, LLC	2
MML CLO	2

Deal	Internal Credit Rating[1]
New NSI Holdings, Inc.	2
Omni Logistics, Inc.	2
Output Services Group, Inc.	2
Partners in Leadership, LLC	3
PeopleConnect Intermediate, LLC	2
Polymer Solutions Group Finance, LLC	2
Preferred Technology Systems, LLC (PTI)	2
Pure Barre, LLC	2
Southern Air & Heat, LLC	2
Sundial Group Holdings LLC	2
Synergy Environmental Corporation	2
The Mitchell Gold Co.	2
Twin-Star International, Inc.	2
Virtium Opco LLC	2

1 – Exhibiting the least amount of risk in our portfolio. Performing above expectations or the issuer's operating trends and risk factors are generally positive.

2 – Exhibiting an acceptable level of risk that is similar to the risk at the time of origination. Generally performing as expected or the risk factors are neutral to positive.

3 – Performing below expectations and indicates that the investment's risk has increased somewhat since origination. May be out of compliance with debt covenants; however, scheduled loan payments are generally not past due.

4 – Performing materially below expectations and indicates that the issuer's risk has increased materially since origination. Generally out of compliance with debt covenants, scheduled loan payments may be past due (but generally not more than six months past due).

5 – Performing substantially below expectations and the investment risk has substantially increased since origination. Most or all of the debt covenants are out of compliance or payments are substantially delinquent. Investments graded 5 are not anticipated to be repaid in full and we will reduce the fair market value of the loan to the amount we expect to recover.

1 Credit rating as of June 30, 2016

Monroe Capital: Current Pipeline - Active Deals with Signed Term Sheets & in Underwriting

DEAL	ALL-IN INTEREST RATE (coupon + LIBOR floor)	EBITDA OF COMPANY ($M)	DEAL SIZE ($M)
Acronis AG	9.5%	$18.0	$65.0
Alloy (Rev)	7.5%	$3.5	$19.5
Alpha Natural (ABL)	11.0%	n/a	$20.0
Care Plus	8.5%	$8.0	$18.4
Incipio (Add-On)	10.5%	$50.5	$75.0
ILG (Add-On)	7.8%	$49.1	$11.1
Lulu's	8.0%	$18.4	$19.0
MWW PR	9.5%	$7.0	$18.0
Palmetto Moon	8.8%	$10.0	$31.0
Repay Holdings	8.0%	$17.0	$73.0
The Worth Collection	9.0%	$6.7	$22.5
Total & W.Avg.	**9.1%**	**$21.2**	**$372.5**

As of July 19, 2016.
Active deal pipeline is provided for illustrative purposes only.
Please see important disclaimers at the back of this presentation.

Monroe Capital: Finance, Accounting, Compliance and Operations Teams

David Jacobson
CFO/CCO

- 34 years accounting / finance exp.
- Catalyst International, Inc.
- Sterling Capital, Ltd.
- C.P.A.

Karina Stahl
Managing Director - Finance & Operations

- 14 years of accounting / finance exp.
- CIFC Asset Mgmt.
- Deerfield Capital Mgmt.
- C.P.A.

James Cassady
Managing Director - Treasury

- 23 years of credit / compliance / finance exp.
- Deloitte
- Orchard First Source
- M.B.A. - DePaul

Corporate Accounting

Shane Massel
Senior Accountant

- 5 years of public accounting exp.
- Silver & Mishkin, LLC
- M.S.A. – Roosevelt University

Fund Accounting

Brianna Werner
Fund Accounting Manager

- 11 years of finance experience
- Greenbriar Asset Management, LP
- Northern Trust Hedge Fund Services

Josue Aguilera
Fund Accounting Manager

- 10 years of accounting/ finance exp.
- Jackson National Asset Mgmt.
- Deerfield Capital Mgmt.

Tom Schultz
Senior Fund Acct.

- 12 years of accounting/ finance exp.
- Jackson National Asset Mgmt.
- Northern Trust

Direct Loan Operations

Lori Popp
Vice President

- 26 years of op./ finance exp.
- Neuberger Berman
- Antares Capital
- CBOT
- M.B.A. – St Xavier

Colleen Platt
Asst. Vice President

- 21 years of op. / finance exp.
- Capital Source
- Antares
- JPMorgan

Marta Sereivaite
Associate

- 6 years of operations experience
- U.S. Bank Corporate Trust Services

Fund Compliance & Operations

Michael Furr
Vice President

- 15 years of finance / underwriting exp.
- Glencoe Capital LLC

Dan Quiat
Associate

- 2 years of finance experience
- Ocean Tomo

CLO Compliance & Operations

Seth Friedman
Vice President

- 10 years of op./ finance exp.
- Pangaea Asset Management
- Capital Source Finance
- LaSalle Bank

Likom Kikama
Senior Associate

- 3 years of CLO operations experience
- U.S. Bank

Data & Information Technology

Jody Geiger
Chief Data Officer

- 26 years of information technologies and software exp.
- Hennessy & Roach, P.C.

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The prior performance of certain Company managed funds set forth herein is provided for illustrative purposes only and may be based on unaudited, preliminary information and subject to change (including as a result of the realization of unrealized investments). Such performance is presented on a net basis and reflects the (i) impact of fees and expenses borne by investors in the referenced Company managed funds and (ii) reinvestment of earnings. Please refer to the Offering Documents for Monroe products for a description of the fees and expenses that will be applicable to investors in Monroe products. Such prior investment performance is not necessarily indicative of Monroe products' future investment results. There can be no assurance that Monroe products will achieve comparable results or be able to avoid losses. In addition, there can be no assurance that investments with an unrealized value will be realized at the valuations shown, as actual realized returns will depend on, among other factors, future operating results, the value of the assets and market conditions at the time of disposition, any related transaction costs and the timing and manner of sale, all of which may differ from assumptions on which valuations contained herein are based.

Monroe Capital: Disclaimer Notice

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Cautionary Note Regarding Forward-Looking Statements
The information contained herein may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect the current views of the Company with respect to, among other things, future events and financial performance. We generally identify forward-looking statements by the terminology such as "outlook," "believe," "expect," "potential," "continue," "may," "will," "should," "could," "seek," "approximately," "predict," "intend," "plan," "estimate," "anticipate," "opportunity," "comfortable," "assume," "remain," "maintain," "sustain," "achieve," "see," "think," "position" or the negative version of those words or other comparable words. Any forward-looking statements contained in this presentation are based upon historical information and on the Company's current plans, estimates and expectations. The inclusion of this or other forward-looking information should not be regarded as a representation by the Company or any other person that the future plans, estimates or expectations contemplated by the Company will be achieved. We caution that forward-looking statements are subject to numerous assumptions, estimates, risks and uncertainties, including but not limited to global economic, business and market geopolitical conditions; U.S. and foreign regulatory developments relating to, among other things, financial institutions and markets, government oversight and taxation; the conditions impacting the private investment industry; the Company's ability to successfully compete for fund investors, professional talent and investment opportunities; the Company's successful formulation and execution of its business and growth strategies; the Company's ability to appropriately manage conflicts of interest, and tax and other regulatory factors relevant to the Company's business; as well as assumptions relating to the Company's operations, financial results, financial condition, business prospects, growth strategy and liquidity. If one or more of these or other risks or uncertainties materialize, or if the Company's assumptions or estimates prove to be incorrect, the Company's actual results may vary materially from those indicated in these statements. These factors are not and should not be construed as exhaustive and should be read in conjunction with the other cautionary statements and risks. Any forward-looking statements contained in this presentation are made only as of the date of this presentation. The Company does not undertake to update any forward-looking statement, whether as a result of new information, future developments or otherwise. Prior returns and performance contained in these materials are not necessarily indicative of future results and all investments are subject to risk of loss.

The reference to Monroe Capital Management Advisors, LLC as an SEC-registered investment adviser does not imply a certain level of skill or training.

DISCUSSION SHEET

ITEM #A3

Topic: **Possible revisions to the Board's Budget Adoption Policy**

Discussion: Staff will discuss proposed revisions to the Budget Adoption Policy as a result of the termination of the Administrative and Audit Advisory Committee (AAAC) at the May 12, 2016 Board meeting.

The proposed revision removes the presentation of the budget at the committee level as there is no longer an AAAC. The revision includes the following schedule:

- First draft presented to the Board at the October Board meeting
- Posting of the proposed budget to the DPFP website following the October Board meeting to allow for member review
- Receipt of member comments in the November Board meeting, with either Board approval of the final budget or Board direction to revise and present final budget in December for approval

Staff Recommendation: **Approve** the Budget Adoption Policy as amended.

DALLAS POLICE & FIRE PENSION SYSTEM

BUDGET ADOPTION POLICY

As Amended Through August 18~~3~~, 2016~~5~~

DALLAS POLICE AND FIRE PENSION SYSTEM

BUDGET ADOPTION POLICY
Adopted November 17, 1994
As amended through August 18~~3~~, 2016~~5~~

The fiscal year shall be January 1 through December 31 of each year. Each fiscal year, staff shall present a proposed budget to the Board of Trustees (Board) according to the following schedule:

1. ~~No later than the month of September of each year, staff will meet with the Audit and Administrative Advisory Committee (AAAC) to review the proposed budget. The AAAC will propose any amendments or changes to the proposed budget.~~

~~2.~~ At the October Board Meeting, the staff shall present to the Board the proposed budget for the following fiscal year~~, as approved by the AAAC~~. The Board shall approve a budget to be presented to the membership for review via the DPFP website.

2~~3~~. At the November Board Meeting, members will be given the opportunity to comment on the proposed budget. The Board or staff may propose changes to the budget in response to member comments. The Board shall either approve the final budget or direct staff to make adjustments based on member comments and bring a revised budget to be presented to the December Board meeting for final approval.

In all cases, the final budget shall be approved by December 31 each fiscal year.

Included with the budget will be a letter from DPFP's actuary stating whether or not the budget will have an adverse effect on the payment of benefits per Section 4.01(a) of the Combined Pension Plan.

In accordance with Sec. 4.01 (d) of the Combined Pension Plan Document, ~~a~~ the approved budget will be submitted to the City of Dallas for comment. The City's budget office may request the Board to reconsider the appropriation for any expenditure at a Board meeting, but the Board shall make the final determination concerning any appropriation.

At any time during the year the staff may recommend to the Board changes to the budget necessary for the efficient and effective operations of DPFP. Any such changes to the budget must be approved by the Board.

Board approval of the budget and any changes to the budget, if applicable, is authorization for staff to pay expenditures up to the total amount budgeted.

Each August, staff will present to the Board a detailed, mid-year analysis of actual expenditures versus the budget.

APPROVED on **August 18~~3~~, 2016~~5~~** the Board of Trustees of the Dallas Police and Fire Pension System.

Samuel L. Friar
Chairman

Attested:

Kelley Gottschalk
Secretary

DALLAS POLICE & FIRE PENSION SYSTEM

BUDGET ADOPTION POLICY

As Amended Through August 18, 2016

DALLAS POLICE AND FIRE PENSION SYSTEM

BUDGET ADOPTION POLICY
Adopted November 17, 1994
As amended through August 18, 2016

The fiscal year shall be January 1 through December 31 of each year. Each fiscal year, staff shall present a proposed budget to the Board of Trustees (Board) according to the following schedule:

1. At the October Board Meeting, the staff shall present to the Board the proposed budget for the following fiscal year. The Board shall approve a budget to be presented to the membership for review via the DPFP website.

2. At the November Board Meeting, members will be given the opportunity to comment on the proposed budget. The Board or staff may propose changes to the budget in response to member comments. The Board shall either approve the final budget or direct staff to make adjustments based on member comments and bring a revised budget to be presented to the December Board meeting for final approval.

In all cases, the final budget shall be approved by December 31 each fiscal year.

Included with the budget will be a letter from DPFP's actuary stating whether or not the budget will have an adverse effect on the payment of benefits per Section 4.01(a) of the Combined Pension Plan.

In accordance with Sec. 4.01 (d) of the Combined Pension Plan Document, the approved budget will be submitted to the City of Dallas for comment. The City's budget office may request the Board to reconsider the appropriation for any expenditure at a Board meeting, but the Board shall make the final determination concerning any appropriation.

At any time during the year the staff may recommend to the Board changes to the budget necessary for the efficient and effective operations of DPFP. Any such changes to the budget must be approved by the Board.

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Board approval of the budget and any changes to the budget, if applicable, is authorization for staff to pay expenditures up to the total amount budgeted.

Each August, staff will present to the Board a detailed, mid-year analysis of actual expenditures versus the budget.

APPROVED on **August 18, 2016** the Board of Trustees of the Dallas Police and Fire Pension System.

Samuel L. Friar
Chairman

Attested:

Kelly Gottschalk
Secretary

DISCUSSION SHEET

ITEM #A4

Topic: **Investment reporting - Maples Fund Services**

Discussion: The Board approved hiring Maples Fund Services in October, 2015 and they were subsequently engaged to provide the Board and staff (i) monthly investment reports, (ii) investment manager transparency reports and (iii) support for ad-hoc reports based on DPFP data. James Perry, the former CIO who resigned from DPFP effective July 19, 2016, began working at Maples effective July 26, 2016.

The Board of Trustee and Staff Statement of Ethics, Section J states:

A Trustee or Employee who leaves the service or employment of the System may not, within twelve (12) months after leaving that service or employment, represent any other person or organization in any formal or informal appearance before the System concerning a project for which the person had responsibility or material involvement as a Trustee or Employee. Moreover, the System will not enter into or renew an existing contract with any entity or any affiliate of any entity during that twelve (12) month period of such Trustee or Employee leaving the service or employment by the System if such entity employs or is represented by the former Trustee or Employee unless the Trustees determine that such a restriction would not be in the System's best interest.

The existing contract with Maples is a month-to-month contract, but the pricing will increase upon the 1-year anniversary as of October 20, 2016. Staff had planned to review the current Maples services, as well as performance reporting alternatives, at the Annual Board Workshop in October.

DISCUSSION SHEET

ITEM #A4
(continued)

Staff Recommendation: **Proceed** with the planned review of performance reporting services, including Maples Fund Services, at the Workshop in October.

DISCUSSION SHEET

ITEM #A5

Topic: **2016 Board/staff workshop**

Discussion: Staff will discuss the workshop plans with the Board.

DISCUSSION SHEET

ITEM #A6

Topic: **Ad hoc committee reports**

Discussion: A brief update on the ad hoc committees will be provided.

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #A7

Topic: **Board Members' reports on meetings, seminars and/or conferences attended**

a. Conference: **Society of Pension Professionals** JS
Dates: July 19, 2016
Location: Dallas, TX

b. Conference: **Wharton: International and Emerging Market Investing** TH, BH
Dates: July 25-27, 2016
Location: San Francisco, CA

c. Conference: **State Pension Committee Meeting** JS, KG
Dates: August 4, 2016
Location: Austin, TX

d. Conference: **TEXPERS Basic Trustee Training Class** SF, KH, TH
Dates: August 14, 2016 JM, JB,
Location: San Antonio, TX
Est. Cost: $100

e. Conference: **TEXPERS Summer Educational Forum** SF, KH, TH,
Dates: August 14-16, 2016 CC, JM, JB
Location: San Antonio, TX

DISCUSSION SHEET

ITEM #A8

Topic: **Chief Investment Officer position**

Portions of the discussion under this topic may be closed to the public under the terms of Section 551.074 of the Texas Government Code.

Discussion: The Executive Director will provide an update on the Chief Investment Officer position.

DISCUSSION SHEET

ITEM #A9

Topic: **Personnel**

To discuss the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of public officer or employee: (i) Chief Financial Officer and (ii) General Counsel. Portions of the discussion under this topic may be closed to the public under the terms of Section 551.074 of the Texas Government Code.

Discussion: The Executive Director will discuss these matters with the Board.

DISCUSSION SHEET

ITEM #B1

Topic: **Reports and concerns of active members and pensioners of the Dallas Police and Fire Pension System**

Discussion: This is a Board-approved open forum for active members and pensioners to address their concerns to the Board and staff.

DISCUSSION SHEET

ITEM #B2

Topic: **Executive Director's report**

a. Future Education and Business Related Travel
b. Future Investment Related Travel
c. Associations' newsletters
- NCPERS Monitor (July 2016)
- NCPERS Monitor (August 2016)
- TEXPERS Outlook (August 2016)
- TEXPERS Pension Observer (Summer 2016)

Discussion: The Executive Director will brief the Board regarding the attached information.

Future Education and Business Related Travel
Regular Board Meeting – August 18, 2016

Regular Board Meeting September 8, 2016

1. **Conference:** **Society of Pension Professionals**
   Dates: September 20, 2016
   Location: Dallas, TX
   Est. Cost: $250.00 Per Person Annually

2. **Conference:** **TLFFRA Pension Conference** (offer PRB New Trustee Core Training)
   Dates: October 1-4, 2016
   Location: McAllen, TX
   Est. Cost: $400

Regular Board Meeting October 13, 2016

Board and Staff Workshop October 17-19, 2016

3. **Conference:** **NCPERS AF Module 3 & 4 classes** (PRB rules for MET)
   Dates: October 22-23, 2016
   Location: Las Vegas, NV
   Est. Cost: $700

4. **Conference:** **NCPERS Public Safety Conference**
   Dates: October 23-26, 2016
   Location: Las Vegas, NV
   Est. Cost: $1,700

* New/No one has signed up

5. **Conference:** **Global ARC Annual Conference**
   Dates: October 24-26, 2016
   Location: Boston, MA
   Est. Cost: $1,775

6. **Conference:** **Society of Pension Professional Annual Summit**
   Dates: October 31, 2016
   Location: Irving, TX
   Est. Cost: TBD

7. **Conference:** **TEXPERS Basic Trustee Training Class** (PRB rules for MET)
   Dates: November 1, 2016
   Location: Irving, TX
   Est. Cost: $100

8. **Conference:** **Opal: Emerging Managers Summit South**
   Dates: November 7-8, 2016
   Location: Austin, TX
   Est. Cost: $1,000

Regular Board Meeting November 10, 2016

9. **Conference:** **IFEBP: Annual Benefits Conference**
   Dates: November 13-16, 2016
   Location: Orlando, FL
   Est. Cost: $3,200

* New/No one has signed up

Regular Board Meeting December 8, 2016

10. **Conference:** **Society of Pension Professionals**
    Dates: December 20, 2016
    Location: Dallas, TX
    Est. Cost: $250.00 Per Person Annually

11. **Conference:** **PRB: MET Online Core Training:** **Benefits Administration**
    Dates: Anytime on line
    Location: http://www.prb.state.tx.us/

12. **Conference:** **PRB: MET Online Core Training:** **Risk Management**
    Dates: Anytime on line
    Location: http://www.prb.state.tx.us/

* New/No one has signed up

Future Investment Related Travel
Regular Board Meeting – August 11, 2016

NONE

* New/No one has signed up

THE MONITOR
The Voice for Public Pensions
July 2016

Bipartisan Policy Center Suggests Shift to Federal Pension Oversight

The Bipartisan Policy Center, a public policy think tank that attempts to find common ground on issues that often divide Democrats and Republicans, has put its stake in the ground on retirement security with a plan that would shift more authority to the federal government.

In "Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings," the Center advocates creating a new retirement arrangement to help workers save efficiently and consistently. The June 9 report is grounded in the principles that Americans don't save enough, are at increasingly high risk of outliving savings, lack basic knowledge of home equity and personal finance, and face an uncertain future with Social Security.

"Taken together, the recommendations contained in this report aim to establish a better savings culture and renew the promise of an adequate retirement — across the income spectrum — for current and future generations of Americans," the Center said.

The centerpiece of the proposals is the Retirement Security Plan. Focused on small employers, this plan would eliminate hurdles to creating multiple employer plans, foster the creation of automatic-enrollment plans for all employees by creating a safe-harbor alternative to nondiscrimination testing, and expand tax incentives. The plan would also transfer the administrative and fiduciary responsibilities of running a plan to a third party that would be certified through the oversight of the Treasury Department and Labor Department.

There is much to agree with in the proposals. For example, the Center underscored the impact of the push away from defined-benefit to defined-contribution plans. "Workers have found themselves part of a great experiment — one that has given individuals and families far more control and responsibility for financing their retirement, and simultaneously exposed them to greater risk." This approach is not working for many Americans, the commission noted. "People need the assistance of a well-designed system as they accumulate, invest, and spend down their retirement savings. Public policy has a critical role to play in facilitating savings and a secure retirement."

However, the Center unnecessarily takes aim at state regulation, advocating for "establishing a nationwide minimum-coverage standard to pre-empt the patchwork of state-by-state regulation that is already developing." NCPERS opposes this approach because it flies in the face of a long-running tradition of keep pension policy at the state level. Congress has not succeeded in finding a comprehensive approach to retirement security strategy that is respectful of the important role public pensions have played for decades. The states, meanwhile, have found common ground. Seven states are already implementing laws creating a state-initiated retirement plans for private-sector employees – an approach developed by NCPERS that fuses the best features of public pensions with more techniques more commonly deployed in the private sector.

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Bipartisan continued from page 1

assistance of a well-designed system as they accumulate, invest, and spend down their retirement savings. Public policy has a critical role to play in facilitating savings and a secure retirement."

The study is the product of a 19-member panel made up of economists, academics, lawmakers, government officials, and industry practitioners. A complete copy or executive summary of the report may be downloaded at www.bipartisanpolicy.org.

Update on Puerto Rico Legislation

On June 9, by a vote of 297-127, the U.S. House approved H.R. 5278, which would create a seven-person oversight board to restructure and manage Puerto Rico's escalating debt. Majorities in both parties supported the measure. The legislation does not contain federal reporting requirements on state and local pension plans (commonly known as PEPTA) or the annuity accumulation retirement plan. Both measures are strongly opposed by NCPERS and the public pension community.

The Senate must now decide how to process the House-passed bill and whether to allow any amendments to it. Senate leadership said previously that, if the House passed the measure by a significant bipartisan majority, then it was likely to simply take an up-or-down vote on the House-passed bill. Senate action is expected to take place before the end of June.

The serious financial situation in Puerto Rico has been used as justification to impose reporting requirements on all state and local governmental plans in the 50 states. According to recently completed audits, Puerto Rico's largest retirement plan, the Employees' Retirement System, will be insolvent sometime in fiscal year 2018, if it stays on its current path. The system has only 0.27 percent of funds necessary to cover the $30.2 billion it owes current and future retirees. The argument has been made that, as goes Puerto Rico's public pensions, so goes the public pensions in the 50 states.

This link was initially made in legislation introduced in December 2015. At that time, Senate Finance Committee Chairman Orrin Hatch (R-UT) introduced S. 2381, his version of legislation to assist Puerto Rico. It included both the Public Employee Pension Transparency Act (PEPTA) and the annuity accumulation retirement plan.

PEPTA would require that, if the funding status of a plan is not calculated using fair market value or the specific interest rates defined in the legislation, the funding status must be recalculated using those interest rates (U.S. Treasury bond yield curve). The result of the recalculation will be that even well-funded pension plans will appear to be poorly funded. This recalculation does not reflect the actual rates of return of the plans or their diverse investments. It will serve only to create negative headlines that will be used by opponents of defined benefit plans.

The annuity accumulation plan, while completely optional for state and local plan sponsors, is clearly being positioned as an alternative and

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ultimate replacement for defined benefit pension plans. As a replacement plan, it has many deficiencies. First, for firefighters and other public safety employees, there are no survivor or disability benefits. These benefits are essential for public safety employees and their families. Second, employee contributions to the annuity plans are prohibited; only employers may contribute. This runs counter to the vast majority of funding streams for public plans where both employees and employers contribute to the plans. Finally, the plan sponsor may choose to lower or not make any contribution to the plan in any given year, provided it is done uniformly. This creates great uncertainty on whether the benefit will be consistently funded year-to-year.

We are pleased that the House did not include PEPTA or the annuity accumulation retirement plan in the legislation it recently approved. The bill does contain a provision dealing exclusively with public pension plans in Puerto Rico. If the oversight board determines, in its sole discretion, that a pension system of the territorial government is materially underfunded, the oversight board shall conduct an analysis prepared by an independent actuary of such pension system to assist the oversight board in evaluating the fiscal and economic impact of the pension cash flows. NCPERS believes that this Puerto Rico-specific pension provision is entirely appropriate.

Please rest assured that NCPERS will continue to be vigilant in its opposition to PEPTA and the annuity accumulation plan, particularly as tax and retirement legislation is considered by Congress in the future. As always, we will keep you apprised of any key developments on these issues. ■

***Tony Roda** is a partner at the Washington, D.C., law and lobbying firm Williams & Jensen, where he specializes in legislative and regulatory issues affecting state and local pension plans. He represents NCPERS and individual pension plans in California, Ohio, Tennessee, and Texas.*

Hank H. Kim, Esq.
Executive Director
& Counsel

Semi-annual State and Federal Webcast Is Slated for July 19

As we enter the second half of 2016, it is a natural time to reflect on what we have accomplished this year and what remains to be done. We will have the opportunity to do just that on July 19 when NCPERS hosts its semi-annual state and federal update webcast. The program begins at 1 pm eastern time, and I hope you will join us for what is certain to be an informative discussion.

Participating alongside me on the webcast will be Bailey Childers, executive director of the National Public Pension Coalition, and Anthony Roda, of the law firm Williams & Jensen. Bailey and Tony are simply two of the best thinkers about the current state of public pensions, and I know you will find their remarks helpful. The most important thing about this webcast is that NCPERS members will have the opportunity to ask questions and offer their perspective. We look forward to your lively participation.

We have a lot to be proud of this year. We staved off significant threats to public pensions in Oklahoma, Indiana, and Missouri. And we racked up affirmative victories in Wisconsin, Kentucky, Alabama, and Louisiana. New Jersey and Maryland became the 6th and 7th states respectively to create state retirement savings arrangements for private-sector employees. This list, of course, is far from comprehensive. You will need to tune in to hear more about how the guardians of public pensions are fighting the good fight at the state level. With most state legislatures now in recess, we will also look ahead to where the action will be in 2017.

On the federal level, we will hear about the latest developments in the Department of Labor's implementation of its ERISA safe harbor regulation, which President Obama ordered to clear the path for states to offer retirement savings arrangements for private-sector workers. The proposed regulation was unveiled last November and the period for public comments ended in January. A final regulation is expected before the fiscal year ends on September 30. We will hear about how the Puerto Rico assistance bill was neutralized to eliminate anti-pension measures, and we will get an update on other federal initiatives and legal developments in the federal courts.

Of course, it's impossible to look into the second half of 2016 without mentioning Election Day. Presidential election years tend to be divisive, as this year's contest dramatically illustrates. It's easy during election season for domestic issues to be crowded out by turmoil elsewhere in the world. We will need to remain consistent, clear, and steady advocates for public pensions throughout this election season to ensure that our voices will be heard over the noise that any election generates.

NCPERS is justifiably proud to have a highly informed and motivated membership base that takes threats to the defined benefit plan model very seriously. Our members are our most effective advocates for the protection and preservation of the pension rights of hundreds of thousands of public-sector workers and retirees. I urge you to carve out an hour from your day to participate in this important webcast. ■

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THE MONITOR
The Voice for Public Pensions
August 2016

Pension Funding Forum Can Help Officials Separate Fact from Fiction

The term "pension funding gap" has taken on a life of its own in recent years, as complex mathematical calculations by actuaries have improbably morphed into a political football. Critics of public pensions seem to be competing to come up with scarier estimates of the gap between future benefits owed to pension beneficiaries versus the funds available here and now to cover them.

Reliable U.S. government information shows a gap of less than $1 trillion, with approximately 30 years to fill it with revenue. On average, state governments dedicate 4.1% of their revenues to pensions, and only five states have a funding gap below 50%. But facts haven't stopped conservative organizations from bandying about an estimated gap of $3.4 trillion – a grossly inflated figure based on the ludicrous assumption that pensions will eke out the 30-year Treasury bill rate over the next three decades. And most analysis conveniently leaves out the fact that many states and municipalities created the existing shortfall by acting like deadbeat dads – skipping out on their financial commitments or not making required full payment when the going got rough during the financial crisis, if not before. Pennsylvania, for example, went 15 years without meeting its obligations in full. Who can be surprised that a shortfall developed?

We at NCPERs work constantly to separate fact from fiction when it comes to public pension funding. We realize, of course, that anxiety can crowd out reason. Political pressure to determine how to cover future obligations is constantly rising, and cannot be ignored. At the same time, we are deeply concerned about legislative measures such as increasing employee contributions, reducing benefits and converting defined benefits plans into defined contribution plans, because they have serious long-term implications for our society. Our research has shown that increased income inequality and economic volatility are some of the prices we pay.

The gamut of funding issues will be in the spotlight of the NCPERS Public Pension Funding Forum, scheduled for August 21-23, 2016, at the Omni New Haven Hotel at Yale University in New Haven, Conn. Now in its third year, the forum has become a critical, must-attend event for trustees, administrators, and other public pension stakeholders because it is one place you can turn for dispassionate analysis and exceptional industry knowledge. I hope you will make time to attend.

One of the highlights of this year's conference will be our luncheon speaker on the closing day, Tuesday, August 23. Our guest will be Robert J. Shiller, Sterling Professor of Economics at Yale University, and a 2013 Nobel Prize laureate in economics for his empirical analysis of the irrational growth of asset prices. Shiller sees the need to democratize and humanize finance as a recurring theme of his works, from 2001's "Irrational Exuberance" and to last year's "Phishing for Phools: The Economics of Manipulation and Deception." He has underscored in his work the transition from defined-benefit plans to defined-contribution plans that got under way around 1980, and has voiced concern that do-it-yourself asset management not only sets many people up for failure because they lack the expertise to invest adequately for their own retirement, but also causes formation and bursting of asset price bubbles.

Another headline topic – investment returns and the assumptions underlying the discount rate—will be explored in depth. This issue has been in the news frequently, most

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Funding Forum continued from page 1

recently with *The Wall Street Journal* reporting July 26 that 20-year annualized returns for public pensions in the U.S. have fallen to 7.47% in fiscal year 2016, "the lowest-ever annual mark recorded" by Wilshire Trust Universe Comparison Service. Never mind that Wilshire only began tracking the statistic in 2000, in the midst of a stock market boom, or that most pension plans are meeting their return-on-investment assumptions, both year-over-year and over the long haul.

The Public Pension Funding Forum is unique in its emphasis on research and expert analysis. Our goal for this program is to inject new thinking that might solve the challenges and preserve and enhance public pension plans. Session topics include advocacy, risk management, and investment strategies. This is the best place to get up to speed right now on some of the most pressing issues facing public pensions. To register for the forum, visit www.ncpers.org/fundingforum.

Beyond Brexit: Britain, Europe and the Pension Wealth of Nations:

The World Pensions Council's M. Nicolas J. Firzli warns the UK to tread slowly following Brexit, as one-nation Tories will try to get a 'better deal' first William Butler Yeats wrote 'Aedh Wishes for the Cloths of Heaven' in 1899, to mark what he thought would be the beginning of a new era in European culture and civilisation: 'Tread softly because you tread on my dreams' says the poet. By voting to leave the European Union on 23 June, Britain has shocked the EU establishment and treaded abruptly on the delicate dreams of pensive EU-utopians across the continent. On 29 June, the leaders of the union's 27 remaining member states gathered in Brussels to stage theatrically their 'concerted riposte', insisting 'Britain make a quick exit' by activating 'immediately' Article 50 of the Lisbon Treaty, formally starting the two-year period leading to withdrawal.

Of course, it will be in England's national interest not to move fast in the coming months: London needs to obtain first written reassurances on the 'free movement of goods, capital, services' from the part of Brussels before invoking Article 50. And the longer the UK waits, well the more political pressure on the Anglophobe faction led by Martin Schulz, a failed Socialist publisher from the Rhine Province (Marx's home state) turned President of the EU Parliament and Jean-Claude Juncker, the ridiculously rigid President of the EU Commission. Britain must use this deliberate delaying tactics to hammer the message that free trade with the UK should be construed as totally separate from 'the free circulation of people' and the forced 'contribution to the EU budget' (a stealth tariff). In this long struggle, Britain will have many allies amongst Dutch, Danish, Swedish and Central European member states (except Poland) who all resent Germany's heavy-handedness.

Who knows? By temporising indefinitely to defend its economic interests, the new UK government may well change the course of European history and finally force the EU establishment itself to reform the rigid Maastricht/Lisbon constitutional framework, thus giving more leeway to Britain and other economically-dynamic Northern and Central European nations and allowing a more nimble union to focus on the free trade of goods and services without undue bureaucratic burdens, modern antitrust law and stronger external borders, leaving the rest to member states (the far more efficient 'European Community' model, conceived by Winston Churchill and Jean Monnet, the Anglophile 'chief architect of European Unity').

Asset ownership and the real balance of power favourable to Britain Freed from the ever-tightening grip of EU directives that are corroding English common law and burying British companies under piles of poorly planned regulations, the UK economy will be free to pursue a more dynamic growth trajectory, unleashing the full potential of British workers and entrepreneurs. The UK will also have the opportunity to deepen its longstanding, privileged economic ties with rapidly growing jurisdictions such as Australia,

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Economic Dynamism and National Pension Wealth:'EU Core' vs. Other OECD Countries

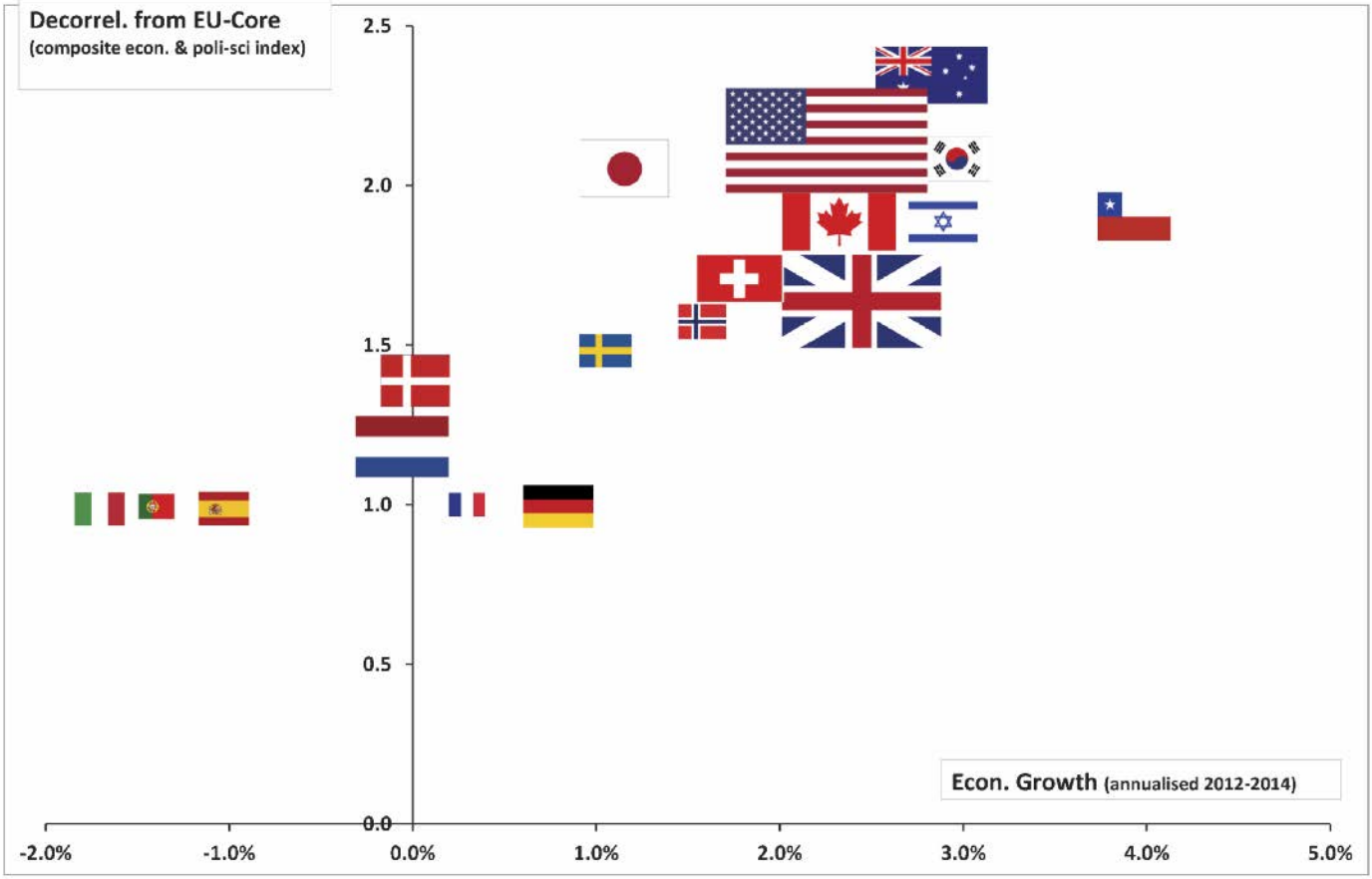

Chart legend:

- **Economic Growth** (x-axis): average annual growth rate of GDP (2012-2014). Source: World Bank national accounts.
- **Decorrel. from EU Core** (y-axis): composite economic, monetary and legal/regulatory indicator (see further description in Section 2). Source: World Pensions Council (WPC) proprietary estimates and the author's recent contributions to Euromoney Country Risk ratings (30 June 2016)
- **National Pension Assets** (flag size): OECD Pension Markets in Focus, 2015 (2014 data); the relative size of US and UK pensions being actually bigger than represented here; Norway data not counting the country's sovereign wealth fund

Beyond Brexit continued from page 2

Canada, India, Singapore and Hong Kong (all growing much faster than the EU average – see chart), without being hindered by Brussels or Berlin.

In our model [see chart], the average annual growth rate is shown on the X-axis. The 'Decorrelation from EUCore' index, shown on the Y-Axis, is a composite economic, monetary and legal/regulatory indicator summarising the overall macro-political distance from 'Core-EU states', defined as Germany, France, Italy, Belgium and Luxembourg (the original members of the 1958 European Coal and Steel Community, with the exception of the Netherlands). For all practical purposes, the 'EUCore' is synonymous with all Western European Eurozone countries including Spain and Portugal – except Ireland, Malta, the Netherlands and Denmark (whose currency is pegged to the euro).

Our research shows that a trade war with London is clearly in no one's interest in Europe, and Britain may have a stronger hand than it seems in future negotiations. The total market capitalisation of UK companies is

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larger than the combined market caps of the Frankfurt and Paris bourses, and, more importantly, assets owned by UK pension funds are more than 11 times bigger than those of all German and French pension funds put together [see chart – the relative size of a country's pension assets is indicated by the size of its national flag].

Put simply, Britain is by far the number one client of most Mainland European investment bankers, asset managers and insurers (not to mention German car and French wine exporters): if need be, at the first hint of threat to the City of London, Her Majesty's Government should be in a position to respond very forcefully, bringing Brussels to reason rather rapidly…

*Written by **M. Nicolas J. Firzli** is director-general of the World Pensions Forum (WPF) and advisory board member for the World Bank Global Infrastructure Facility*

Proposed Amendments to Bankruptcy Code

In the winter of 2011, the U.S. House held hearings on a proposal to extend the Chapter 9 federal bankruptcy protections to states. Municipalities are allowed to enter into debt restructuring under Chapter 9, if authorized by state law, but states are not afforded these protections.

One of the key arguments for the proposal was that states were overburdened by promises, statutory in nature and some protected by state constitutional guarantees, to pay retirement benefits to state and local workers. The proposal landed with a thud. Bipartisan sentiment in Congress was that states, as co-sovereigns with the federal government, should not be afforded these protections. While not desirable outcomes, states could raise taxes, issue bonds or cut other spending to get out from under its debt. Further, extending debt restructuring to states would have serious implications for the bond markets.

Fast forwarding to 2016 we now see a more narrow approach being advanced by the Manhattan Institute, an ultra-conservative think tank. Using the troubled Illinois public pension system as justification, the proposal would create a new section 113 of the U.S. Bankruptcy Code – Proceeding to Protect Essential State Actions. How would this work?

States would be allowed to publish a proposal to make changes to pension benefits that, in the state's view, are necessary and/or appropriate to ensure the undiminished and unimpaired performance of any essential state action by the state or any subdivision, agency or municipality thereof. One or more public hearings would be required and any such proposal would have to be approved by the state legislature and signed by the governor in the same manner as general statutes of that state. Such legislation (the proposal to change benefits) would then be filed as a petition in a U.S. Bankruptcy Court.

It's critical to understand what state or local legal protections of benefits would be cast aside by this new bankruptcy provision. The proposal states that, pension benefits may be modified to ensure the performance of essential state actions, notwithstanding any prohibition against or limitations on changes to pension benefits contained in any state constitution, statute, law, regulation, judicial decision, contract or other local legal document, decision or rule.

To understand the broad sweep of this proposal, it's important to look at two key definitions:

- **Essential State Action** – any undertaking by the state in furtherance of (a) providing for the health, safety or welfare of persons residing within the state; (b) addressing, remedying or preventing fiscal emergencies of the state or any subdivision, agency or municipality thereof; or (c) ensuring the ability of the state and its subdivisions, agencies and municipalities to fund essential governmental services on reasonable terms.

- **Pension Benefits** – any accrued or prospective, vested or unvested, pension, health or other employee or retiree benefit, which a state or any subdivision, agency or municipality thereof, funds or is required to fund.

The proponents of the proposal cite the authority for section 113 as the

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Hank H. Kim, Esq.
Executive Director
& Counsel

Semiannual State and Federal Webcast Spotlights Victories, Emerging Issues

Significant attacks on public pensions were averted during the first half of 2016, but challenges lie ahead. That was the message of NCPERS semiannual state and federal update webcast on July 19.

NCPERS executive director and chief counsel Hank H. Kim on July 19 moderated the discussion, which featured Bailey Childers, executive director of the National Public Pension Coalition, and Tony Roda, a partner in the Washington, D.C., law firm of William & Jensen. In keeping with the established format of the webcast, they began by reviewing the first half of 2016, looked ahead to the second half, and fielded questions submitted by members.

Looking Back

The most significant challenge faced by public pensions at the federal level in the first half of 2016 was enveloped in urgent legislation to stabilize the finances of Puerto Rico. In December 2015, Senate Finance Committee Chairman Orrin Hatch (R-Utah) included pension measures in his bill to help Puerto Rico cope with a crippling $70 billion debt load.

"It was a success for our community" that these two provisions were dropped by the time President Obama signed the relief bill into law on June 29, Roda said. The first provision, known as the Public Employee Pension Transparency Act, or PEPTA, would have required pension plan sponsors to recalculate their funded levels and submit that information to the U.S. Treasury Department. "That doesn't sound so bad, but the recalculation would have to be done using fair market value of assets and the Treasury bond yield curve, which would make even the best-funded pension plans look very poorly funded," Roda said.

The other deleted provision was Hatch's annuity accumulation plan, which would have allowed plan sponsors to purchase annuities for employees each year in lieu of providing other pension benefits. This approach was objectionable because it would have provided no survivor or disability benefits for public safety workers, counter to longstanding public policy, Roda said.

At the state level, it was another good year, with no defeats and "a couple of proactive wins," said Childers. Wisconsin passed a bill allowing municipalities that don't offer pensions to join the Wisconsin Retirement System, effectively expanding public pension benefits in the state. And Oklahoma, in what Childers described as "a unique approach," created the mechanism for a rainy day fund for its pension plans.

"The other big-picture good news is that public pension funding across the board continues to improve," Childers said. "The hits that pensions took during the recession have been a catalyst for people to say let's get rid of them. But now, as long as states are making the payments like they are supposed, pension systems are recovering. They can weather an economic storm; they just have to take time."

Attempts in Indiana and Alabama to switch to hybrid pension plans or a cash-balance model were stopped during the first half of 2016, Childers added.

Alaska, which has broached the idea of returning to a defined-benefit plan, didn't pass legislation this year, but the topic got a committee hearing and may have traction in the next legislative session, Childers added. "Alaska is one of the states that recognize that this experiment with moving to defined contribution plans" doesn't deliver the promised benefits.

What's Ahead

Congress begins its traditional August recess on the heels of the Democratic and Republican national conventions in July. And with Election Day looming on Nov. 8, Congress will return on Sept. 6 for only one month, Roda said. "The only must-pass

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legislation during this time is the budget resolution," he said. But that doesn't mean public pension issues will be dormant. He identified three issues that could arise:

- The Hatch bills could resurface as amendments to other pending legislation. The first opportunity will be S.1714, a bill to shore up pension and retiree health benefits for retired mine workers, Roda said. Hatch will mark up this bill in September, and a defensive battle could follow.
- Rep. Robert Dold (R-Ill.) introduced a bill in June that prohibits state funds through the Elementary and Secondary Education Act from using those funds to cover the unfunded liability of pension plans. The measure failed when it was previously introduced, in 2015, but it could come to the floor of the House in September, Roda said. In the latest iteration, any system that is funded 50% or greater was exempted. The bill introduces new terminology that will need to be defined.
- The Social Security Administration's Windfall Elimination Provision (WEP), which affects how retirement and disability benefits are calculated, was scheduled to come before the House Ways and Means Committee in July, but this action was postponed. Opponents of WEP, including NCPERS, have called it arbitrary and unfair. Roda noted that Ways and Means Chairman Kevin Brady (R-Texas) is committed to bipartisan action to treat teachers, firefighters, and police officers who paid into Social Security the same as other American workers. Brady may "put the bill back together" during August, when Congress will be in recess, Roda said.
- A lame duck session of Congress is a definite possibility, but the chances of it will probably rest on the outcome of the presidential election, Roda added.

At the state level, meanwhile, many moving parts will require careful monitoring, Childers said:

- The next six months will be relatively quiet for the states, with only a few legislatures remaining in session. The Michigan Legislature and the Pennsylvania General Assembly are two exceptions, and Childers said she and her team will be staying on top of developments there. In both states, the push has been on for several years to shift various groups of public employees into defined contribution or hybrid plans.
- In 2017, Texas and Nevada – two large states whose legislatures were not in session in 2016 – will be back in session.
- The activities of several foundations and coalitions with an anti-pension agenda remain a deep concern. The Laura and John Arnold Foundation and the Pew Charitable Trust have renewed their partnership, with close to $10 million now committed to promoting hybrid and side-by-side plans in states including Alabama, Pennsylvania, and Kentucky. The Retirement Security Initiative, a conservative group, is doing significant anti-pension work in Nebraska, Pennsylvania, and Arizona. "We've sent letters to all state legislators to let them know Pew has an agenda they are pushing across the US. It's not specific to any state," Childers said. Anti-pension activity at the municipal level is particularly troubling, she added.

During the question-and-answer session with members, Kim turned to what he called "the elephant in the room" – the 2016 presidential election. Roda noted that Democratic nominee Hillary Clinton has a longer track record on retirement issues than her opponent, Republican nominee Donald Trump. Trump has said very little on the issue, except for clearly opposing cutting Social Security benefits. However, Roda pointed out, the GOP platform says all options should be on the table.

Childers said she will be following the elections with an eye to changes of party at the legislature and gubernatorial level. "We might have new threats, and we might have new opportunities to do more proactive work," she said. And inevitably, she added, "there will be a lot of new legislators. We will need to do education to help them understand what pensions are, why they matter, and why they work for their state."

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Bankruptcy Clause to the U.S. Constitution, which gives Congress the specific power to enact uniform laws on the subject of bankruptcies throughout the U.S. In addition, the Manhattan Institute's white paper states that the U.S. Supreme Court has held that the Constitution "does not impair Congress' ability under the Bankruptcy Clause to define classes of debtors and structure relief accordingly."

The proposal includes the ability of an affected person to challenge a petition by demonstrating, by clear and convincing evidence, that the petition is unnecessary. However, in evaluating challenges, the Bankruptcy Court must defer to the judgment of the state legislature and the governor regarding revenue and spending, unless there is no rational basis underlying that judgment.

Legislation has not yet been introduced on this proposal. Such legislation would be referred to the House and Senate Judiciary Committees. Be assured that NCPERS will closely monitor this proposal for any Congressional interest. ■

[1]Railway Labor Executives' Association v. Gibbons, 455 U.S. 457,473 (1982).

***Tony Roda** is a partner at the Washington, D.C., law and lobbying firm Williams & Jensen, where he specializes in legislative and regulatory issues affecting state and local pension plans. He represents NCPERS and individual pension plans in California, Ohio, Tennessee, and Texas.*

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Texas Lawmakers Playing Key Role in Trying to Eliminate WEP

The Windfall Elimination Provision (WEP) is an arbitrary policy that needlessly harms public servants such as teachers, firefighters, police officers and others who have worked public-sector and private-sector jobs, U.S. Reps. Kevin Brady (R-Texas) and Richard Neal (D-Mass.) wrote in an opinion article published by The Hill.

Brady, who has served Texas's 8th District since 1997 and is chairman of the House Ways and Means Committee, and Neal are leading the charge to repeal the WEP and replace it with a formula that calculates Social Security benefits for public servants just like other workers.

"The WEP arbitrarily reduces benefits by using a special formula for public servants who spent years working in Social Security-covered jobs and non-covered jobs," the two wrote in the article.

They are sponsoring a bill, the Equal Treatment of Public Servants Act of 2015 (H.R. 711), that would replace the WEP with a simple, proportional adjustment to benefits based on the percentage of a beneficiary's total earnings (from their 35 highest-earning years) that were earned in uncovered employment.

"We propose looking at all lifetime earnings and using a proportional formula to calculate Social Security benefits. In other words, two workers with the same lifetime

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earnings – one who has spent an entire career in Social Security-covered employment and another who has worked in both covered and non-covered work – will receive a Social Security benefit that is calculated the same way," the two wrote. "Instead of arbitrarily reducing benefits, if a public servant only spent half of her career paying into Social Security, she will receive 50 percent of her Social Security benefit – just like someone who spent an entire career paying into Social Security receives 100 percent of his benefit."

AARP acknowledged in a separate article that Texans are playing key roles in the WEP fix. In addition to Brady, another prominent Texan on Capitol Hill – Rep. Sam Johnson (R-Plano), who chairs the Social Security Subcommittee – also backs H.R. 711.

Also actively working to fix the problem is Texan Tim Lee, who as executive director of the Texas Retired Teachers Association (TRTA) leads the largest association for retired public and higher education employees in the country, said AARP, which also supports H.R. 711.

Lee has been working for years on a solution that will help teachers and other affected parties, AARP said.

"He notes that retired teachers are currently losing hundreds of dollars a month in much-needed Social Security benefits and that the problem may be keeping many Texans from becoming teachers at all," AARP said.

H.R. 711 would benefit approximately 95 percent of all Texas public school teachers, as well as many retirees in teaching and other fields, the article stated.

AARP President Jeannine English, who along with TRTA's Lee recently testified to Congress about this topic, said the proposed bill represents "a fair solution that will benefit the 1.6 million workers affected by the current… policy." This includes nearly 150,000 Texans.

Meanwhile, Stephen C. Goss, chief actuary at the Social Security Administration, wrote a letter to Brady answering Brady's written request for an estimate of the financial effects on the Social Security Trust Funds if legislation such as H.R. 711 were passed.

The letter is available at: https://www.ssa.gov/OACT/solvency/KBrady_20160712.pdf.

On the Web at: http://thehill.com/opinion/op-ed/287481-making-social-security-fair-for-all, http://states.aarp.org/texans-playing-key-roles-social-security-benefit-fix/, http://waysandmeans.house.gov/wp-content/uploads/2016/03/H.R.-711-Fact-Sheet.pdf, http://bipartisanpolicy.org/blog/bpc-analysis-of-h-r-711-the-equal-treatment-of-public-servants-act/ and https://scitechnation.com/retirees-receiving-a-public-pension-may-be-unprepared-for-reduced-social-security-benefits/.

Public Pensions Provide Reliable Benefits and the Ability for Beneficiaries to Change Jobs

Nearly all state retirement systems have features that allow for the preservation of retirement income benefits, even for those employees who decide to change jobs, according to a new report by the National Institute on Retirement Security (NIRS).

NIRS found that public defined benefit (DB) pension plans meet two top concerns of Americans when it comes to retirement finances: the need for reliable, adequate retirement income that will not run out and the ability to move retirement plans from job to job.

Almost all public retirement systems offer DB pensions that provide a modest, but stable retirement income that lasts through retirement. In addition, nearly all state retirement systems have features that allow for preservation of retirement income benefits even for employees who change jobs via the purchase of service credits, interest credits on withdrawn contributions and re-depositing of employee contributions, according to the report, "Preserving Retirement Income Security for Public Sector Employees."

Nearly all public DB systems also allow members to purchase additional service credits to increase their pension benefits in retirement. Specifically, all public DB plans allow for the purchase of service credits for prior military service, and more than half of the plans surveyed allow for the purchase of credits for prior out-of-state government service. Some plans allow for the purchase of credits for other specified types of service and leave.

The report results were based on a survey of 89 public pension plans to determine plan types, employee contribution rates, vesting requirements, interest rates paid on withdrawn employee contributions, refunds of member accounts, re-deposits of employee contributions and ability to purchase service credits.

All survey results for the 89 public pension systems were published in the Appendices to the report. For systems that did not reply to the survey, data was obtained from the Public Plan database, National Association of State Retirement Administrators reports, and public pension plan web sites.

On the Web at: http://www.nirsonline.org/index.php?option=content&task=view&id=935.

Bipartisan Think Tank Proposes Plan to Shore Up Social Security for 76 Years

The federal government should make the Social Security's benefit formula more progressive to help fix the program's solvency issues, according to a 13-point proposal by the Bipartisan Policy Center (BPC) that promises to secure Social Security for more than 75 years and modernize the program to better meet the needs of the changing U.S. workforce.

The proposal includes initiatives to increase benefits for workers who pay payroll taxes for more than 35 years, set a basic minimum benefit, and raise retirement ages to keep up with increased longevity.

Other measures proposed by the BPC, a nonprofit Washington, D.C.-based think tank, are to lower cost-of-living adjustments for bigger benefits in the future, place a limit on the nonworking spousal benefit, and scrap the windfall elimination provision (WEP) and government pension offset (GPO).

The Social Security proposals are part of a comprehensive report by the BPC that addresses six major challenges to retirement security.

Social Security benefits for current retirees are financed by payroll taxes from current workers and withdrawals from the Social Security trust fund. The trust fund is scheduled to be exhausted in 2034, at which point current law requires benefits to be reduced to the level that payroll taxes alone can support – about 77 percent of scheduled benefits.

The BPC's 19-member Commission on Retirement Security and Personal Savings comprised political leaders, retirement experts, academics and industry executives. Its compromise plan for Social Security blends new revenues and restraint on future benefits.

The commission believes beneficiaries with the highest incomes should make proportionally larger contributions on both revenue increases and benefit constraints. The BPC proposals would close 54 percent of the funding shortfall by adding revenue and 46 percent by adjusting benefits. The BPC argues that addressing the program's challenges now will prevent sudden and disruptive reductions in benefits in 2034.

Taken as a package, the BPC proposals would enhance benefits for low-income workers, widows and widowers, while reducing benefits from the current schedule for affluent workers and beneficiaries.

On the Web at: http://bipartisanpolicy.org/library/retirement-security/.

NCPERS Counters Claims that Federal Intervention Would Fix Woes of State and Local Pensions

Hank H. Kim, executive director and counsel of the National Conference on Public Employee Retirement Systems (NCPERS), has penned a response to an opinion article in The Wall Street Journal arguing for the abolishment of public-sector defined-benefit (DB) pension plans.

In the article, Ed Bachrach, founder and chairman of the Center for Pension Integrity, echoes the alarmism of other opponents of public pension funds, claiming that state and local government pensions are, collectively, "trillions of dollars in the hole."

"This debt is crippling budgets and will dump an enormous burden on future generations," Bachrach wrote.

As a solution, Bachrach says Congress should pass a law allowing states and local governments to reduce promised public employee pension benefits, even though it is illegal under some states' statutes or constitutions.

In addition, states and local governments should be required to terminate their DB plans and replace them with defined-contribution (DC) plans, like 401(k)s or 403(b)s. Active employees also should be able to be enrolled in Social Security, Bachrach wrote.

Only pension plans that are in very bad shape should qualify for this "relief," he added. Then, states and localities could mandate a later retirement age, such as age 65, for example, and could cap payments at 150% of the median income in the local jurisdiction, Bachrach wrote. Automatic cost-of-living increases that now exceed expected inflation could instead be tied to increases in the median income, he wrote.

Troubled plans should qualify for "relief" only if their funding ratio falls below 50% and has failed to improve over the past five years, he said.

Once these steps are taken, state and local governments should be required to fully fund the remaining pension liabilities with a tax increase. In other words, to receive the "relief" of reducing promised benefits, they must agree "to solve the pension problem once and for all."

"What would this look like in practice?" Bachrach wrote. "Let's say that a retired firefighter in a troubled pension plan is set to receive $70,000 annually. If that is below 150% of the median income in his local jurisdiction, under federal relief his annual benefits would never be subject to the cap, since they would rise as the local median income increases."

However, if a public employee held multiple jobs and qualified for more than one public pension, he or she would not be able to collect more than one of the pensions and would have his or her benefit reduced to meet the 150% cap.

Kim responded by saying that Bachrach was correct in observing that state and local governments should close the pension-funding gap they have created. However, he said that Bachrach exaggerated the size and the immediacy of the shortfall – the gap is less than $1 trillion spread over 30 years, Kim wrote, according to the 2015 Census of Governments.

"These costs equal 4% of expected state revenues – hardly the 'crippling' problem he [Bachrach] sees," Kim wrote.

In addition, governments created the funding shortfalls by relying excessively on regressive and volatile revenue schemes such as casinos, lotteries and "sin taxes," Kim wrote, and reneged on their pension funding commitment during the economic downturn.

"Mr. Bachrach's solution – federal legislation allowing states and local governments to reduce promised pension benefits – is unfair to workers who faithfully made every required contribution and violates a host of constitutional, contractual and property-rights principles," Kim wrote.

"There is a better way. State and local governments can adopt more progressive, broad-based revenue systems with lower rates. Governments should stop giving away twice as much in economic development incentives as they have committed to spend on pensions. Pension checks are spent locally and domestically, unlike money given to corporations through tax loopholes and subsidies. Other solutions include using well-designed pension obligation bonds and improving risk management."

On the Web at: http://www.wsj.com/articles/how-to-save-public-pensions-no-federal-bailout-needed-1468797730 and http://www.ncpers.org/files/WSJ%207_26_16_printed.pdf.

New GASB Accounting Standards Being Felt in State Pension Funding Levels

State pension funding levels were little changed in fiscal year 2015 from the year before, according to a recent policy brief by the Center for Retirement Research at Boston College that provides an overview of the latest funding information.

The funded status of state and local pension plans based on the Governmental Accounting Standards Board's traditional rules (GASB 25) increased slightly in 2015. The main reason was that, despite the poor stock market performance in 2015, returns over the last five years have been strong, according to the report.

Conversely, the funded status based on the new GASB 67 rules, with assets at market value, showed a slight decline in the funded rate primarily due to the subpar 2015 returns.

Covering 160 state and local plans, the report finds that their aggregate funded ratio increased slightly from 73% to 74% in 2015 under the traditional GASB rules based on smoothed assets, but decreased from 74% to 72% in the same year under the new GASB standards.

Funded levels differ significantly among plans. About 20% of the plans are less than 60% funded while 36% have a funded ratio equal to or above 80%.

The Actuarially Determined Employer Contribution (ADEC) – formerly the Annual Required Contribution (ARC) – as a percentage of payroll rose to 18.6% in 2015, compared to 17.6% in 2014. Required employer contributions have grown substantially over the last 15 years, from 6.7% in 2001 (measured by the ARC) to 18.6% in 2015 (measured by the ADEC), mostly due to the growing unfunded liability amortization component. The overall share of required contributions actually paid also increased to 90.8% in 2015, compared to 86% in 2014.

The aggregate 74% funded ratio was derived from the average 7.6% discount rate. If a much more conservative 4% discount rate were used, the funded ratio would drop to 45% and the total unfunded liability would rise from $1.2 trillion to $4.1 trillion, according to the report. Only 10 among 160 plans adopted a significantly lower "blended rate" in 2015.

Looking forward, the funded ratio is projected to grow to 77.6% in 2020 if the plans' own return assumptions are realized. However, the ratio will likely fall to 71.2% if the returns are lower, as predicted by major investment firms.

On the Web at: http://crr.bc.edu/wp-content/uploads/2016/06/slp_50.pdf.

Public Pension Funds Benefit with Less Political Interference

Public pension funds need to be protected from interference by elected officials so they can focus on their core duties without distraction, author Simon C.Y. Wong argues in an article published by the Harvard Business Review.

At a time when public funds are facing substantial deficits, a tumultuous global economy and a low-return environment, government officials are enacting undue hardships, such as the imposition of local economic development obligations, excessive constraints on head counts and compensation requirements that impede recruitment of talented staff.

Combined, this interference has contributed to poor investment choices, higher total costs, diminished organizations, and disappointing performance at some institutions, Wong writes.

In his experience, he said, "pension funds that succeed in keeping politics at bay combine strong governance with deft, often pre-emptive, management of issues that could spark a political backlash."

On the Web at: https://hbr.org/2016/07/public-pension-funds-perform-better-when-they-keep-politics-at-bay.

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Beneficiaries' Key Decision: When to Claim Social Security

Older Americans can maximize their Social Security retirement benefits by taking a few key steps, such as not filing for their benefits as soon as possible when reaching their full retirement age, according to an article in MarketWatch.

If seniors delay their retirement benefits until they turn 70, they can reap an 8%-per-year increase in their monthly benefit. Beneficiaries are advised to seek professional guidance to determine the right time to claim Social Security, as the decision depends on various factors, including life expectancy and income sources.

The article provides the basics beneficiaries need to know about Social Security, and provides a detailed explanation of the rules regarding the most important decisions when claiming benefits.

On the Web at: http://www.marketwatch.com/story/how-to-get-the-biggest-social-security-check-you-can-2016-07-24.

Americans Now Plan to Save Seven Years Longer for Retirement

Americans work an average of five years longer than their global counterparts – 35 years versus 30, respectively – in order to have enough money to retire, according to new research. In addition, 44% of American pre-retirees wish they started saving earlier and 33% say they should have saved more by putting aside a larger share of income.

Despite beginning to save for retirement earlier and working more years than their global counterparts, many working age Americans still do not think they are saving enough, according to HSBC Group research.

Americans preparing for retirement expect to save seven years longer than current American retirees did, the research found.

HSBC's report also uncovers that almost one in seven (14%) of working-age people have still not started saving for their retirement, including 3% of those aged 60 or over.

On the Web at: http://www.businesswire.com/news/home/20160718005754/en/.

Financial Advisers Offering Little Guidance on Social Security

Less than one-third (32 percent) of future retirees work with a financial advisor – but only half of these (52 percent) say their advisor provided no guidance or advice on Social Security, according to the Nationwide Retirement Institute.

It's not that they don't want advice. In fact, 76 percent of future retirees who work with a financial advisor – or plan to – say they are likely to switch to one that could show them how to maximize their Social Security benefits.

Those findings are consistent with the past two years' study results. A lot of this is due to the fact that most advisers wish they had more information about Social Security rules and regulations. Most advisers do not have extensive knowledge about it, so they do not bring it up to their clients.

On the Web at: https://www.nationwide.com/about-us/061616-social-security.jsp.

SEC Tries to Simplify Disclosure Requirements as Part of Overall Disclosure Effectiveness Review

The Securities and Exchange Commission (SEC) has voted to propose amendments to eliminate redundant, overlapping, outdated or superseded regulations as part of changes to its disclosure requirements, U.S. Generally Accepted Accounting Principles (U.S. GAAP), International Financial Reporting Standards (IFRS), and technology.

The SEC also is seeking public comments on certain disclosure requirements that overlap with U.S. GAAP to determine whether to retain, modify, eliminate or refer them to the Financial Accounting Standards Board (FASB) for potential incorporation into U.S. GAAP.

The amendments, along with the input received on the Regulation S-K concept release, are designed to further inform the SEC's actions to enhance disclosure.

On the Web at: https://www.sec.gov/news/pressrelease/2016-141.html.

Many DC Plan Participants Not Confident in Their Retirement or Approach to Investing

Many participants in defined contribution (DC) plans are still not confident in their approach to saving and investing, according to J.P. Morgan Asset Management's fourth research study of plan participants.

There appears to be a "human disconnect" between participant intent and action, and "a potential misperception about participant support for automatic features and strategies may be holding plan sponsors back from strengthening" their DC plan.

In addition to looking at results for participants as a whole, the paper, "Guiding Participants from Intent to Action: 2016 Defined Contribution Plan Participant Survey Findings," examines similarities and differences across investor types, such as "do it for me" or "do it yourself" investors.

The survey of 1,001 DC plan participants found most are still uncertain that a financially secure retirement awaits them because: more immediate financial demands interfere with their ability to save for the future; many don't have a clear understanding of how to set a retirement savings goal; and most are not confident in their ability to make investment decisions.

On the Web at: http://www.prnewswire.com/news-releases/jp-morgan-defined-contribution-survey-reveals-plan-participants-still-not-confident-in-their-approach-to-investing-support-automatic-retirement-plan-features-300303281.html.

Koch Funded University Programs Seen as Undermining Traditional DB Pension Plans

The Koch Foundation gives grants to programs at about 300 universities across the United States. It says its funding is designed to promote academic freedom and rigorous debate of diverse ideas. But opponents of the Koch Foundation's involvement in higher education counter that the money is being spent to produce studies advocating the elimination public-sector defined benefit (DB) pension plans.

Troy University in Troy, Ala., is one of the schools at the center of the controversy. Troy has ordered changes at its Manuel H. Johnson Center for Political Economy, steering the center's professors away from "political activism," according to a memo to university trustees, al.com reported.

The move comes after comments made by a Johnson Center economics professor at a conference were recorded and publicized by a group opposed to the Charles Koch Foundation's involvement in higher education. The Johnson Center is partly funded by the Koch Foundation.

An email from Chancellor Jack Hawkins' office to Troy University trustees calls for a "refocus" of the Johnson Center faculty to concentrate solely on teaching, academic research and service, al.com reported.

The memo announces a 90-day moratorium on public policy pronouncements, opinion writing "or any other activities that can be construed as political activism."

The appointment of Johnson Center economics professor George Crowley as chair of Troy's Department of Economics and Finance was cancelled, the memo says.

It was Crowley whose comments were recorded and publicized by a group called "UnKoch My Campus."

The group maintains that the Koch Foundation promotes its own interests through university programs like the Johnson Center.

Johnson Center professors have published research on the Retirement Systems of Alabama, calling for reforms, including a change to defined contribution plans, like 401 (k) plans, for future employees, al.com reported.

That has put the center at odds with the RSA's outspoken chief executive, David Bronner, who has publicly criticized those recommendations and the Koch Center's influence at Troy.

On the Web at: http://www.al.com/news/index.ssf/2016/07/troys_johnson_center_steers_aw.html and http://www.unkochmycampus.org/.

Options for Financing State and Local Pension Obligations Detailed in New Report

The Brookings Institution has published a policy brief looking at public pensions and the different ways to bring into balance poorly funded systems.

The authors conclude that the legacy costs of these pension plans should be covered by some combination of overall tax increases and spending cuts, while the new costs that would otherwise accumulate could be mitigated by "judicious reform proposals."

On the Web at: http://www.brookings.edu/~/media/research/files/papers/2016/19-rsp-policy-brief/pb-pension-shortfalls-and-sl-budgets.pdf.

NCPERS Assesses 'Total Compensation': Cost Basis Versus Relative-Value Basis

The National Conference on Public Employee Retirement Systems (NCPERS) has published a paper looking at two ways of assessing the compensation packages of public employees.

"The competitiveness of a public employer's total compensation package and the ability to recruit and retain talent is not just about how much the compensation package costs the employer or how important the total rewards are to the employee," the report states. "Rather, both employers and employees need to understand the value that the total compensation package delivers."

Two methods of measuring total compensation – cost basis and relative value basis – can provide the bargaining parties with valuable information that can be helpful in demonstrating the relative merit of benefits as part of a comparative total compensation analysis, the report states.

Often, the bargaining process simply focuses on the dollar cost of benefits and the resulting trade-offs that occur between direct and indirect compensation.

"This comparison is useful but does not tell the entire story," the report states. "Taking plan design differences into consideration adds a dimension of relative value, thereby giving all parties a more complete picture of the value of benefit design elements. This information enhances understanding of the total compensation arrangement between employers and employees."

On the Web at: http://www.ncpers.org//files/NCPERS%20Research%20Series_2016_Total_Compensation_Web.pdf.

401(k) Participants Sue over High-Cost Plans

Some employers are facing lawsuits for providing 401(k) plans that charge higher fees than the alternatives for similar low-cost plans, according to an article in Money.

These lawsuits have prompted many companies to include low-cost index funds to replace pricey stock-picking funds in their plans.

As a lawsuit against New York Life Insurance illustrates, even index funds can charge unnecessary costs. A proposed class-action lawsuit against the insurer by its workers is just one of several similar suits brought in recent years.

That suit challenges the company's decision to offer a Mainstay S&P 500 index fund, which charges investors $35 per year for every $10,000 invested.

According to an analysis from Morningstar cited by the article, the typical index investor only pays about $20 per $10,000.

Moreover, 401(k) investors often pay lower fees than other investors because plans can pool their assets to gain discounts, the article stated.

In this case, New York Life should be able to offer its employees an essentially identical stock index fund from Vanguard that costs just $2 per $10,000 invested, the suit charges.

On the Web at: http://time.com/money/4419492/401k-index-fund-fees-lawsuit/.

NASRA Examines State and Local Governments' Contributions to Public Pension Plans

Since fiscal year 2014, there has been an improved effort among state and local governments to make full actuarially determined pension contributions, according to a new report by the National Association of State Retirement Administrators (NASRA). In addition, there has been a decline in the rate of growth of pension costs.

Nationally, contributions made by state and local governments to pension trust funds in recent years account for around 4 percent of all spending, the report found.

"Pension spending levels, however, vary widely among states and are actuarially sufficient for some pension plans and insufficient for others," the report stated.

Unlike employees, who must always contribute the amount prescribed in statute or by plan rules, some public employers – states, cities, etc. – have discretion to set the contributions they make to public pension plans.

"The result of this disparity in contribution governance arrangements is a wide range of experience among public employers concerning required contributions," the report states.

The report describes how contributions are determined; the recent public employer contribution experience; and trends in employer contributions over time.

On the Web at: http://www.nasra.org/files/Issue%20Briefs/NASRAADCBrief.pdf.

U.S. Ranks 14th in the World in Retirement Security

The United States ranks 14th for retirement security, according to the 2016 Global Retirement Index, released July 19 by Natixis Global Asset Management.

The index examines key factors that drive retirement security and provides a comparison tool for best practices in retirement policy across 43 countries.

American investors are acutely aware of increasing the need for individuals to fund a greater share of retirement. In a survey of investors conducted by Natixis earlier this year, 75% said this responsibility increasingly lands on their shoulders.

However, many Americans may be underestimating how much money they need to save in order to retire comfortably. Investors estimate they will need to replace only 63% of their current income when they retire, well short of the 75% to 80% generally assumed by planning professionals.

In addition, a large segment of Americans simply does not have access to employer-sponsored savings programs such as 401(k) plans. The U.S. Department of Labor estimates that one-third of the nation's workforce does not have access to a retirement plan. A separate Natixis survey of participants in defined-contribution plans found that, even when they have access to a plan, four in 10 contribute less than 5% of their annual salary.

"Retirement used to be simple: Individuals worked and saved, employers provided a pension, and payroll taxes funded government benefits, resulting in a predictable income stream for a financially secure retirement," said John Hailer, CEO of Natixis Global Asset Management in the Americas and Asia.

On the Web at: http://www.businesswire.com/news/home/20160719005936/en/.

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N.Y. Pension Fund to Sell All Holdings in U.S. Retailers that Sell Guns

The $59 billion New York City Employees' Retirement System voted in July to divest itself of all its holdings of three American retailers because they sell guns.

The fund is selling shares in Dick's Sporting Goods, Cabela's and Big 5 Sporting Goods. The holdings, worth $10.5 million as of mid-June, are about 0.02 percent of the pension's portfolio, according to a letter to the board of trustees from the city's public advocate as reported by The New York Times.

The fund also will continue to press ahead in its efforts to get Walmart and a division of the supermarket chain Kroger to remove guns from their store shelves.

On the Web at: http://www.nytimes.com/2016/07/15/business/dealbook/new-york-city-pension-fund-to-divest-itself-of-gun-retailer-stock.html.

New Regulations Designed to Enhance Order-Handling Information for Investors

Newly proposed regulations for the first time would require broker-dealers to disclose the handling of institutional orders to customers. The Securities and Exchange Commission's (SEC) proposed rules also would expand the information included in existing retail order disclosures.

The new regulations are intended to bring order-handling disclosure in line with modern technology and market practice, providing valuable information to retail and institutional investors about how their orders are treated, said SEC Chair Mary Jo White in a statement.

"This information should provide investors more transparency and a powerful new tool to more effectively monitor broker-dealer routing decisions, especially when combined with the additional disclosures from alternative trading systems proposed by the Commission late last year," she added.

On the Web at: https://www.sec.gov/news/pressrelease/2016-140.html.

Mass. State Pension Better Managed than Transportation Workers' Fund

The Massachusetts Bay Transportation Authority Retirement Fund (MBTARF) would be worth $902 million more had the fund's assets been managed since 2000 by the state pension fund, according to new research.

Over the last decade, the fund's leadership was riddled with scandals and lack of transparency, resulting in soaring costs and a heavily unfunded plan, according to a policy brief written by Iliya Atanasov of the public policy research firm Pioneer Institute.

The MBTA's pension contributions doubled from $35 million in 2007 to $70 million in 2015, and are expected to rise to $78 million in 2016. The plan was only 64.9% funded in 2014, compared to 97.4% in 2005. Worse, the plan raised the assumed rate of return from 7.5% to 8% at the same time that pension boards were revising discount rates downward across the country.

If the fund's assets had been managed by the Pension Reserves Investment Management (PRIM) Board in charge of the state pension fund, their value would have been $902 million higher, and the MBTA's pension plan would have been fully funded by 2014, according to the research.

The plan also would have saved $119 million in unnecessary contributions for fiscal 2014-2016, and would save $49 million in 2017.

The MBTARF's excessively risky investments were blamed for the low returns and high management expenses. The fund's target asset allocation for 2014 included 30% in alternatives, of which hedge funds made up 11% and private equity 10%. Junk and unrated debt also accounted for 36% of the fund's fixed income investments in 2014.

Meanwhile, over the period studied, PRIM cut its costs substantially from already restrained levels while the MBTARF's investment expense ratio remained high.

In 2010-2014, PRIM's average direct expense was less than 15 basis points, whereas the MBTARF's was more than 48, the report found.

"Placing MBTARF assets under PRIM's management will give MBTA pensions a chance of survival and help preserve retirees' savings," the report stated. "Unlike the secretive MBTARF, PRIM is subject to all state ethics and transparency standards."

On the Web at: http://pioneerinstitute.org/better_government/study-t-pensions-worth-902m-assets-managed-state-pension-fund-2000/.

Business Continuity and Transition Plans for Investment Advisers, New SEC Rules Propose

Registered investment advisers would have to adopt and implement written business continuity and transition plans under a new rule proposed by the Securities and Exchange Commission (SEC).

The proposed rule is designed to ensure that investment advisers have plans in place to address operational and other risks related to a significant disruption in the adviser's operations in order to minimize client and investor harm.

Business continuity and transition plans would assist advisers in preserving the continuity of advisory services in the event of business disruptions – whether temporary or permanent – such as a natural disaster, cyber-attack, technology failures, the departure of key personnel, and similar events, the SEC said.

On the Web at: https://www.sec.gov/news/pressrelease/2016-133.html.

Public Pension Funds Largest Group of Alternative Investors

Total assets managed by the top 100 alternative investment managers globally reached $3.6 trillion, up 3% from the prior year, according to new research by Willis Towers Watson.

Pension fund assets represented one-third (34%) of the top 100 alternative managers' assets, followed by wealth managers (19%), insurance companies (10%), sovereign wealth funds (6%), banks (2%), funds of funds (FoFs) (2%), and endowments and foundations (2%), according to the research, which included data on a diverse range of institutional investor types.

The alternative asset management industry continues to be remarkably reliant on pension fund money and has earned a position of trust by delivering diversified returns via some of the most highly skilled investment teams around, however, there is an ever-increasing demand for more alignment and lower cost, according to the research.

The findings were based on the Global Alternatives Survey, which covers 10 asset classes and seven investor types. It showed that of the top 100 alternative investment managers, real estate managers had the largest share of assets (34% and over $1.2 trillion), followed by hedge funds (21% and $755 billion), private equity fund managers (18% and $640 billion), private equity funds of funds (PEFoFs) (12% and $420 billion), funds of hedge funds (FoHFs) (6% and $222 billion), infrastructure (5%) and illiquid credit (5%).

U.S. Pension fund assets, managed by the top 100 asset managers of pension funds, increased again from the year before to reach almost $1.5 trillion. Real estate managers continued to have the largest share of pension fund assets with 40%, followed by PEFoFs (20%), hedge funds (10%), private equity (9%), infrastructure (8%), FoHFs (7%) and illiquid credit (4%).

The research showed, among the top 100 managers, that North America continues to be the preferred destination for investment in alternative assets (50%), with illiquid credit and infrastructure being the only asset classes where more capital is invested in Europe. Overall, 37% of alternative assets are invested in Europe and 8% in Asia Pacific, with 5% throughout the rest of the world.

On the Web at: https://www.willistowerswatson.com/en-PH/press/2016/07/Investors-go-alternative.

COLAs Not Guaranteed for Public Fund Beneficiaries, N.J. Supreme Court Rules

The New Jersey Supreme Court in July ruled that retired public employees do not have a contractual right to receive increasing cost-of-living adjustments, a decision that could affect public pensions across the country.

The ruling "eliminates a major threat to the state's fiscal stability," said Moody's Investors Service analyst Baye Larsen in a statement.

The status of the state's roughly $83 billion pension system has never been worse. The state's aggregate funded ratio for all plans is 48.6 percent.

Gov. Chris Christie's administration suspended the COLA payments, which are tied to inflation, as part of 2011 reforms aimed at curtailing the ballooning cost of public pensions. The court ruling is expected to save the state $17.5 billion.

Wendell Steinhauer, president of the New Jersey Education Association, a teachers union, said the benefit freeze is "theft, plain and simple."

New Jersey Justice Barry Albin dissented from the majority, saying he did not agree that the statutes lacked clarity.

In deciding when to retire, "public employees relied on the legislative promise that COLAs would protect their pensions from the ravages of inflation," Albin wrote.

On the Web at: http://www.reuters.com/article/us-new-jersey-pensions-lawsuit-idUSKCN0YV1NF.

SUMMER 2016

THE TEXPERS®

PENSION OBSERVER

THE OFFICIAL PUBLICATION OF THE TEXAS ASSOCIATION OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS

The Millennial Effect:

By Alexander J. Snyder, CFA

Urban Demand Drives Multifamily Fundamentals

Multifamily construction has been on the rise in nearly every major U.S. city, leading some to speculate that the uptick in volume may be pointing to a sharp reversal of the 7 year bull run in market rent growth. However, this increased supply largely represents a rational response to a fundamental demographic shift in where people want to live. Led primarily by the millennial and baby boomer generations, and aided by steady job growth, demand for higher-end metropolitan apartments has been — and continues to be — robust. This leads us to the belief that while new supply may cause rent growth to moderate from recent highs, it will continue to trend positive.

Demand: Urbanization

Since the depth of the real estate-led financial crisis, multifamily homes have garnered a larger percentage of total U.S. households in comparison to single-family starts. In fact, approximately 9.1 million households have become renters since 2004.[1] This shift is due in large part to the Millennial generation—77 million 18-to-36 year olds representing 24% of the U.S. population[2]—who have shunned suburban homes for city apartments. They gravitate towards apartments because it allows them to

(Continued on page 5)

Venture Capital: Global Quest for Unicorns

By Kirsten Morin

The $1 billion startup was once a rarity, but myths exist for a reason, hence why such a company has become known in the venture capital world as a unicorn. Today, the global herd of unicorns has swelled to more than 150 members with a total cumulative valuation of $526 billion, according to CB Insights. Many of these leading startups were born and bred in Silicon Valley.

Silicon Valley is likely to remain the epicenter of technology given its density of engineering talent and pervasive innovation culture. But there is now a spreading culture of entrepreneurship across countries outside the U.S.

> *... the global population has come online, meaning that the scale of the opportunity that businesses see in front of them today has multiplied. With a globally connected population, there's also information symmetry.*

As capital efficiency increases to help companies achieve better product/market fit, a series of global winners has started to crop up. This means venture capitalists could benefit by widening their lens outside the California region.

Europe, Israel and Asia have increasingly attracted the attention of both local and international venture capital investors. Recent heady valuations in the U.S. are likely playing a part in their sudden willingness to track down opportunities off the beaten path.

But U.S. venture capital firms are probably also taking notice of the fact that category-leading companies are emerging from all corners of the world. China, for example, has three of the 10 largest global internet companies.

The global market for entrepreneurship continues to grow as more and more workers, particularly millennials, are foregoing traditional corporate roles to embrace the start-up scene as a desirable career path.

(Continued on page 11)

MARK YOUR CALENDAR

TEXPERS SUMMER EDUCATIONAL FORUM

August 14 - 16, 2016

Grand Hyatt Hotel
San Antonio, Texas

Sunday, August 14, 2016
(Note Date Change)
Basic Trustee Training
Plan Sponsors Only

Registration Is Open

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WASHINGTON OUTLOOK

By Matthew Aukofer

Cost of Federal Tax Breaks Given to State and Local Governments Could Be Revealed

The Federal Accounting Standards Advisory Board (FASAB) on June 2 proposed a new standard intended to give the public more information about the U.S. government's "tax expenditures," or what the average taxpayer thinks of as "deductions" or "credits."

The proposal would shed more light on what the federal government gives up in tax breaks to state and local governments, among other beneficiaries. If approved, the new standard could provide ammunition to groups that want to reduce these tax breaks as a way of eliminating the federal budget deficit.

FASAB, a U.S. federal advisory committee whose mission is to develop generally accepted accounting principles (GAAP) for federal financial reporting entities, defines these "tax expenditures" as "provisions in the tax law available to subsets of taxpayers who engage in certain kinds of activities, face special circumstances, or otherwise meet specified criteria."

These tax expenditures can include deductions, credits and other tax provisions used by the federal government to encourage behavior that will accomplish public policy goals such as facilitating homeownership, reducing the cost of borrowing for state and local governments, improving higher education and encouraging domestic energy production.

All of these provisions cost the federal government money. According to the Treasury Department, current tax rules that let filers deduct their state and local income and property taxes from the income they declare to the federal government cost $84 billion in lost revenue just this year. An additional $32 billion is lost to state and local governments' much-beloved tax exemption for municipal bonds, which critics have been trying to repeal for years.

But the largest federal deduction by far is the one employers get for their contributions to employee health insurance premiums and medical care. That cost the feds $211 billion in lost revenue this year alone. For perspective, the federal budget is a little less than $4 trillion, while the budget deficit is a little more than $500 billion.

But the largest federal deduction by far is the one employers get for their contributions to employee health insurance premiums and medical care. That cost the feds $211 billion in lost revenue this year alone. For perspective, the federal budget is a little less than $4 trillion, while the budget deficit is a little more than $500 billion.

FASAB says its proposal, dubbed Tax Expenditures: Management's Discussion and Analysis and Disclosure Requirements, is designed to improve the awareness and understanding of tax expenditures by highlighting "the service efforts, costs, and accomplishments of the U.S. government including] those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures."

The proposal is designed to require the U.S. government's official financial reports to include information on the existence, purpose and impact of tax expenditures on federal revenues and the overall financial position of the federal government.

Justin Marlowe, a public finance professor at the University of Washington, told Governing that the change "would draw more attention to the particularly big areas of deductions and exemptions," and would help critics of those expenditures make a case for getting rid of them.

Both Congress and President Obama have proposed limiting or repealing the tax

(Continued on page 15)

PRESIDENT'S CORNER

By Paul R. Brown

Today's pension realities: public employees' pensions have been under attack from the right, and that war has intensified. Sharp drops in the stock market brought losses in asset values of as much as a third for some funds. Pension funds continue to fend off critics and still run their systems with diligence and the fiduciary responsibilities of their boards of trustees.

A major threat to public-sector pensions is the decline of private-sector pensions. The reason for this is due to demographic changes and market trends combining to force public pension plans to turn to the taxpayers for support; those taxpayers are going to be less willing to kick in more money when they themselves enjoy no such benefit. Eighty-four percent of state and local workers have access to a defined-benefit plan, the percentage for private-sector workers has declined from 42 percent in 1990 to only 18 percent and pension envy results.

Eighty-four percent of state and local workers have access to a defined-benefit plan, the percentage for private-sector workers has declined from 42 percent in 1990 to only 18 percent and pension envy results.

Public pensions' ratio of active employees to beneficiaries, has declined to less than 2 to 1. That has made the funds more dependent on investment returns, but the outlook for those is not good either. Recent conversations have once again focused on the means to ensure adequate contributions from all parties.

The stock market has been extremely volatile, and pension plans will have their second straight year of meager investment returns.

(Continued on page 4)

EXECUTIVE DIRECTOR'S COLUMN

By Max L. Patterson

Clarifying PRB MET Reporting Requirements

Texas pension systems have already reported on training to the Pension Review Board (PRB) on March 1 in compliance with the Minimum Education and Training (MET) Program and will be doing so again by October 1, and every March 1 and October 1 thereafter. The October report should reflect training completed between February 1 and August 31 of each year, and the March report should contain training completed between September 1 and January 31.

Please note that the PRB is mandated to report training compliance to the Legislature in November 2016, but will provide an update after the March 1 reports are due, which will reflect all reported training completed by the December 31, 2016, deadline for current trustees & administrators (those that were serving prior to January 1, 2015).

By December 31, current trustees and administrators must meet the MET requirement of seven hours of training over seven core content areas. The following information hopes to clarify some of the more common questions that have been asked. Once a trustee has completed the initial seven hours and it has been reported to the PRB, the System will not report that training for that trustee again. Then, beginning January 1, 2017, the trustees will move into the Continuing Education (CE) portion of the MET program and be required to take four hours of training in core or non-core content areas every two years. So, by December 31, 2019, these trustees must meet the CE requirement.

In the case of a new trustee or administrator, they have one year from the first date of service to obtain the seven hours of training over the seven core content areas. Once they complete that first year of service, they will move into the 2-year CE cycle. Training above and beyond the minimum required hours is encouraged: however, trustees cannot "skip ahead:" for example, if a current trustee who has completed their 7-hour core takes additional training before December 31, it will not count towards their 4-hour CE requirement which begins January 1, 2017.

TEXPERS is offering Basic Trustee Training, which meets the MET initial requirement, on August 14, 2016, in San Antonio prior to the Summer Educational Forum (registration now open) and on October 31, 2016, in Irving prior to the NSIIP conference ... After this year the frequency of BTT may change and it may not be offered on the Saturdays prior to the start of conferences.

When completing MET reporting to the PRB, it is possible that you will not have training to report for a current or new trustee because they have yet to take training for the CE requirement and the deadline for them to do so is not imminent. The PRB has provided a "No Training to Report" box on the reporting form for such a case.

TEXPERS is offering Basic Trustee Training, which meets the MET initial requirement, on August 14, 2016, in San Antonio prior to the Summer Educational Forum (registration now open) and on October 31, 2016, in Irving prior to the NSIIP conference (more information available soon, registration will open in August). After this year the frequency of BTT may change and it may not be offered on the Saturdays prior to the start of conferences. The scheduling of future training dates will be contingent on the number of persons signing up for the training. Therefore don't put off training thinking that it can always be obtained at some pre-determined date.

If you have questions, contact Barbara Zlatnik (713-622-8018 or Barbara@texpers.org).

PRESIDENT'S CORNER

By Paul R. Brown

(Continued from page 3)

Moody's warns that "the two year hit will effectively wipe out the funding progress plans made in 2013 and 2014."

Society adopted a fundamental value that public workers are entitled to a reliable measure of retirement security in exchange for their service. That social value is considered a core promise that governments are obliged to meet. That same measure should be extended to all workers.

Once again we are poised to defeat plans to replace defined benefit plans. Elections have consequences and we play hard politics. The election cycle is winding down and we support those who support us, regardless of political affiliation. That philosophy has shown to be very successful. We evaluate the candidates where they stand on our issues. Check partisanship at the door and look to see where the candidates stand on our issues and whether or not they have our backs when it comes to protecting pensions.

Have a GREAT summer and we will see you in San Antonio in August.

Check partisanship at the door and look to see where the candidates stand on our issues and whether or not they have our backs when it comes to protecting pensions.

www.texpers.org

The Millennial Effect

By Alexander J. Snyder, CFA

(Continued from page 1)

live an urban lifestyle, and they stay longer in apartments as they delay standard life transitions such as marriage and children.

This trend looks to continue. The percentage of young adults aged 26-34 still living with their parents has dramatically increased over the past decade, hitting nearly 15% of the population in 2014, an almost 5% increase since 2002.[3] As these households eventually unbundle, it is likely a large percentage of these Millennials will choose apartment living, providing a continued renter pool for apartment owners.

The low-maintenance, high-energy urban lifestyle hasn't only appealed to the young. Record numbers of empty nesters are choosing to sell suburban single-family homes in favor of urban locales, increasing proximity to amenities and decreasing maintenance. Typically able to afford higher quality, higher rent units, this older generation added nearly 100,000 renters to the multifamily market per year from 2010 to 2013,[4] a trajectory that likely will continue over the coming decades, further amplifying the urbanization trend.

Coastal metropolitan areas have exhibited the healthiest urbanization story, and robust demand has prompted further construction in these markets. The common justification...is that coastal urban cores will likely see the greatest continued population and job growth, coupled with constrained supply due to unavailable developable land.

Supply: Coasts

Coastal metropolitan areas have exhibited the healthiest urbanization story, and robust demand has prompted further construction in these markets. The common justification of both lenders and equity investors is that coastal urban cores will likely see the greatest continued population and job growth, coupled with constrained supply due to unavailable developable land. The second major cause of the focus on urban development is construction costs – over the last few years, they have risen so far beyond inflation that often only Class A assets with high rents can justify the cost to build.

Even outside the coastal cities, apartment construction has risen, but it is important to note that while it's above trend on an absolute unit basis, it is still only average as a percent of existing inventory. Further, total housing construction (that is, including single family homes) is actually still below average historical measures. The new and interesting phenomenon is that the mix of single-family and multifamily housing has skewed in favor of apartments, causing cranes to be seen in city centers while suburban land lots remain grassy.

Outlook

It appears likely that 2016 will see apartment fundamentals moderate slightly from the strong pace set in 2015 and normalize towards a long-term average in 2017. Absent a recession, fundamentals of multifamily value assets will need not "correct", as new supply coming online is largely justified by strong demand. Steady job growth, an absence of overall new home supply in most markets, and the living preferences of the Millennial and Baby Boomer generations should all contribute to attractive returns and a solid fundamental picture for the multifamily sector in 2016 and beyond.

Alexander J. Snyder, CFA, is Senior Analyst at CenterSquare Investment Management in Plymouth Meeting, PA.

1 U.S. Bureau of the Census, Raymond James Research, January 8, 2016.
2 "Millennials Prefer Cities to Suburbs, Subways to Driveways," nielson.com, March 4, 2014.
3 BEA, BLS, Census and Green Street Advisors, November 13, 2015.
4 "Empty Nesters Flock to Apartment Living", multifamilyexecutive.com, November 19, 2014, Axiometrics, Inc.

Multifamily Supply as a % of Existing Stock

Source: Citigroup Global Markets, as of November 2015

The Timeless (and Timely) Case for High-Yield Bonds

By Michael Weilheimer, CFA, Steve Concannon and Will Reardon

High-yield bonds occupy a special capital market niche. As obligations of companies with below-investment-grade credit ratings, they offer higher yields to compensate investors for accepting additional credit risk. High-yield bonds have offered better risk-adjusted returns than equities and lower interest-rate sensitivity than the broad fixed-income market.

Better risk-adjusted returns than stocks

Over the past decade, the BofA/Merrill Lynch US High-Yield Master II Index has produced the same total return as the S&P 500 (6.5%), with about two-thirds of the volatility, resulting in a higher Sharpe Ratio of 0.50 vs. 0.35.

Lower interest-rate sensitivity than bonds

The high income stream from high-yield bonds helps lower their duration compared with broad investment-grade indices, and has resulted in performance with negative correlation with other fixed-income asset classes. For example, the Barclays U.S. High-Yield Index has had a -0.26 correlation with the Barclays U.S. Aggregate Bond Index over the 10 years ended December 31, 2015. High-yield bonds have the highest yield per unit of duration of all sectors (except floating-rate loans, which yield less).

Positive performance in rising rate markets

Rising rates are often an indicator of a strengthening economy. Because high-yield bonds are proxies for the credit strength of lower-rated companies, bond prices often move in tandem with equities. For example, over the 20 years ended December 31, 2015, during periods when 5-year U.S. Treasury yields gained 70 basis points (bps) or more in three months, high-yield bonds have averaged a gain of 2.5%, compared with a 3.0% returnthe S&P 500 and a loss of 1.4% for investment-grade bonds, according to JPMorgan.

Even during the weak part of economic cycles, a diversified portfolio of high-yield bonds, like the JPMorgan Domestic High-Yield Index, has shown resilience. Over the past 35 years, the JPMorgan Index has had just five years with negative total returns, compared with seven for the S&P 500.

Opportunities in today's market

Concerns over sluggish global growth and depressed prices in the energy sector sparked a sell-off in the high-yield sector in 2015 that has carried over into early 2016. As is often the case when broad market sentiment reaches a negative extreme, even bond prices of issuers with strong fundamentals have been driven below what we consider to be fair value, with a corresponding widening of spreads relative to U.S. Treasurys. As of January 31, 2016, the spread on the Barclays U.S. High-Yield Index was 787 bps – 214 bps above its 10-year median, and the widest it has been since November 30, 2009, during the financial crisis. The yield to maturity was 9.3%.

High yield has a history of strong rebounds

The history of high-yield bonds has taught us that patience is often rewarded. The table below shows 25 instances since 1988 (when high-yield spreads were first tracked) through December 31, 2015 in which spreads were about as wide as they were on that date (plus or minus 30 bps). Annualized total returns for the three subsequent years ranged from 5.7% to 19.3%, with a median of 11.7%.

Worries about the energy sector and credit quality that have helped drive the high-yield sell-off are legitimate concerns — default rates are indeed likely to rise. However, the market is already discounting default rates that are several times the current level. From our perspective, the timeless (strategic) argument for high-yield bonds and the timely (tactical) case both are very strong.

Michael Weilheimer

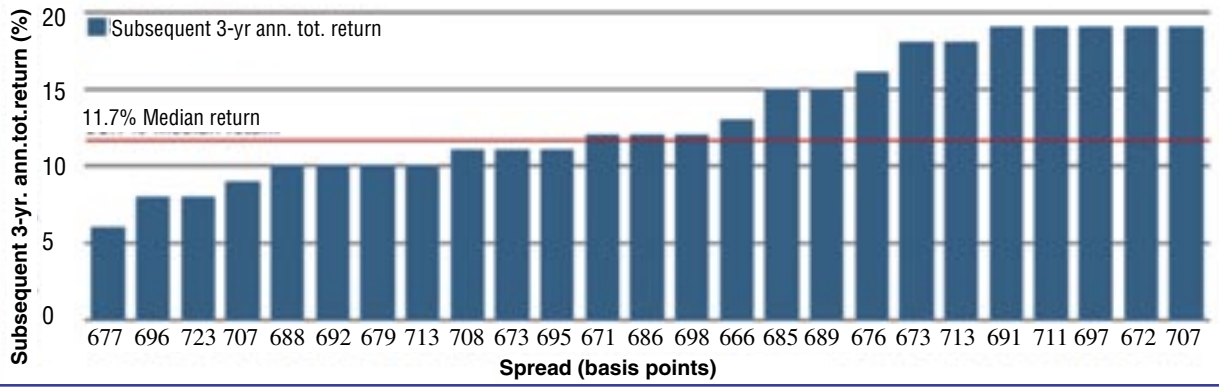
Steve Concannon

Will Reardon

Michael Weilheimer, CFA, is Director, High-Yield Investments; Steve Concannon is Portfolio Manager, High-Yield Investments; and Will Reardon is Institutional Portfolio Manager, High-Yield Investments at Eaton Vance Management in Boston, Mass.

When high-yield bonds have gotten this "cheap," investors have been rewarded.

Since 1988, there have been 25 times when the HY spread was +/– 30 bps of the 695-bps spread on December 31, 2015.



Sources: Morningstar, BofA/Merrill Lynch as of December 31, 2015, based on monthly data. Data are provided for informational use only. Returns are based on the BofA/Merrill Lynch High-Yield Master II Index. Past performance is no guarantee of future results.

Closing the Investment Gap: The Impact of GICS Reclassification of Real Estate

By Michael Grupe

Removing REITs and other real estate companies from the Financials Sector of the Global Industry Classification Standard (GICS) and elevating them into a new Real Estate Sector is expected to have far-reaching, positive implications for the listed real estate securities market. The reclassification is being made by S&P Dow Jones Indices and MSCI, who jointly manage GICS, and will officially occur following the market close this August 31st.

The new real estate sector's equity market capitalization will be made up of approximately 97% Equity Real Estate Investment Trusts and 3% Real Estate Management & Development companies, while nortgage REITs will continue to be listed within the financials sector.

For pension fund managers, the three most important effects of this reclassification may be increased capital flows into equity REITs, reduced trading volatility, and a heightened focus on equity REITs as a source of portfolio diversification.

Increased Visibility & Capital Flows

An immediate result of this reclassification will be increased recognition that equity real estate securities, including REITs, are part of the real estate asset class, a distinct asset class within the investment universe.

According to real estate investment advisor, Cohen & Steers, equity fund managers are currently significantly underweight real estate, a fact that will become more apparent once the GICS reclassification occurs. Research from Morningstar and Cohen & Steers suggests the average real estate weighting for a mid-cap value fund is 5.8% versus the index weighting of 15.1%. Discrepancies like this, of greater or lesser magnitude, exist across the entire spectrum of actively managed equity investment products. To close this gap, some industry analysts have estimated between $30 billion to $100 billion of incremental buying may take place if, over time, generalist fund managers move towards a market neutral position.

The reclassification of real estate also will likely lead to the creation of new investment products. Advisors and managers will have more fund options to recommend to their clients. This will further encourage positive capital flows into listed real estate equities, particularly listed equity REITs.

Reduced Volatility

Separating real estate stocks from the financials sector may also help reduce REIT share price volatility. The financials sector historically has been one of the market's most volatile sectors, with significant sensitivity to interest rate fluctuations. The inclusion of REITs in investment products based on the financials sector has contributed to REIT volatility. Removing REITs from these products may help reduce it. Additionally, broader ownership of real estate stocks, including REITs, over time should result in greater liquidity for this market, further contributing to reduced volatility.

To close this gap, some industry analysts have estimated between $30 billion to $100 billion of incremental buying may take place if, over time, generalist fund managers move towards a market neutral position.

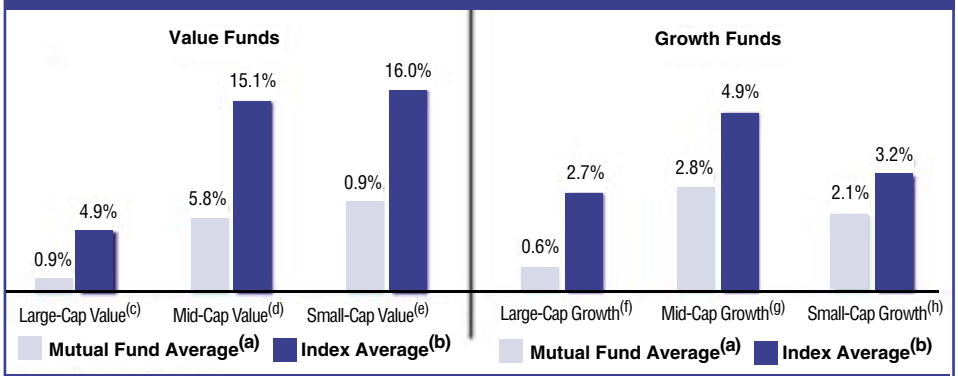
A Stronger Portfolio Diversifier

The reclassification of equity REITs from financials sector stocks, their removal from investment products based on the financials sector, and the increased recognition that listed equity REITs are part of a separate real estate asset class should help lower the correlation of equity REIT returns with those of financials and other equities. Reduced correlation with other sectors of the market will enhance equity REITs' already significant value as a portfolio diversifier.

Over time, the elevation of real estate into its own GICS Sector may significantly impact how REITs are utilized within investment portfolios. Increased capital inflows, along with a reduction in overall volatility and market correlation, could contribute meaningfully to the growth of the equity REIT market and long-term shareholder returns. Certainly, none of these things will happen entirely on September 1st. But it is important for investment managers to understand the long-term REIT investment opportunity that the reclassification of real estate in GICS may present.

Michael Grupe is Executive Vice President, Research and Investor Outreach at National Association of Real Estate Investment Trusts in Washington, D.C.

Real Estate Weightings at December, 2015 [1]



1. Source: Morningstar and Cohen & Steers (a) Mutual fund weights based on the median real estate weighting of all funds in their respective Morningstar category that reported holdings data on the date of analysis, based on oldest share class. (b) Index weight as represented by the most common benchmark for funds in each category. (c) 276 funds/Russell 1000 Value Index. (d) 100 funds/Russell Mid Cap Value Index. (e) 95 funds/Russell 2000 Value Index. (f) 304 funds/Russell 1000 Growth Index. (g) 165 funds/Russell Mid Cap Growth Index. (h) 171 funds/Russell 2000 Growth Index.

Risk Lenses: The Essential Nature of Risk

By Andrew Junkin, CFA, CAIA

Each institutional investor is unique, with unique investment challenges and goals. Beyond organization-specific goals —this quarter's benefit payments, for example — there is a common ambition: to provide long lasting support for future generations. This measure of success is sustainability.

However, there is no single route to sustainability, but rather, risks common to every institutional investor. Some are purely investment risks, some are fundamental (non-investment) risks, and some are a combination of both. Ultimately, these should be considered holistically and made an explicit part of the investment process.

There are six critical risks:

1. Drawdown Risk: The risk of sustaining steep losses
2. Inflation Risk: The risk of decay in the purchasing power of assets
3. Illiquidity Risk: The risk of having insufficient cash to meet short-term needs
4. Active Risk: The risk of underperforming a target asset allocation on a net-of-fees basis
5. Investor Behavior Risk: The risk of making unproductive, irrational or impulsive decisions in the face of uncertainty
6. Shortfall Risk: The risk of having insufficient assets to meet financial obligations

By enhancing the investment process to include these universal risks as lenses for viewing the global investment environment, it is possible to develop a holistic framework and a common language to facilitate essential strategic discussions.

Most pension plans today are cash flow negative — spending more than they take in. The logic behind the impact of cash flows is simple, but radically changes the aim of investing. Preventing significant losses and providing ample liquidity for future expenditures becomes a critical part of any holistic investment program (i.e., managing the interaction of drawdown, shortfall and illiquidity risks). Focusing on maximizing real wealth (i.e., inflation and shortfall risks), rather than percentage return, and managing these other risks, is what leads to sustainability.

The Four Horsemen — Plus Two More

The four horsemen of institutional real wealth destruction are: drawdown risk leading to permanent loss, illiquidity, inflation and behavioral biases. These risks can sometimes go underappreciated if managed independently. Instead, their interactive characteristics demand a holistic approach to portfolio design, construction and monitoring.

Drawdowns

In today's low return environment, it is common to see broadly diversified portfolios with 50% or more invested in equities, which can lead to 80%-90% of the overall portfolio risk coming from equity allocation. While it seems improbable that asset owners can support their missions without the long-term returns of equities, investors must be mindful of drawdown risk and be aware of the frequent conflict between shortfall risk and drawdown risk. Recreating stressed markets with current portfolios can help asset owners prepare for future events, determine steps to mitigate the risk of drawdowns and weigh the cost to the investment program's expected long-term return.

Inflation

Inflation is a critical investment risk for asset owners with long-lived expenditures. Even with oil prices plummeting in 2014-2015, inflation has eroded 21.4% (2% annualized) of investors' purchasing power over the last 10 years and 55% (2.2% annualized) over the last 20 years. This slow erosion of purchasing power can have a significant impact on a pension plan's ability to meet their benefit obligations.

Illiquidity

Illiquidity can be a source of returns as access to public markets can be costly for corporations and markets can be sufficiently fragmented to make private capital advantageous. The illiquidity premium is frequently cited as one of the drivers of historic and expected returns for private markets. Consequently, many investors have embraced less liquid strategies including private equity, private real assets, and hedge funds. However, as illiquidity increases in a portfolio that has spending requirements, so does the potential for forced liquidations of assets — public or private — at significantly impaired prices. Drawdowns combined with spending needs can compound in potentially dreadful ways. Adding illiquidity to that same scenario can be devastating to an overall investment program. When market prices periodically veer away from economic values, forced sellers must take whatever price is offered. Protecting against such a calamity is part of a well-designed portfolio and requires an examination of liquidity throughout the portfolio as well as plans for maintaining enough liquidity to manage through a meaningful downturn.

Active risk

The risk of unsuccessfully pursuing alpha can also impair asset owners' ability to meet their mission. Historically, any return not attributable to asset allocation — or the beta exposures of a portfolio — was deemed alpha, driven by skill. As markets have evolved, the understanding of alpha has changed. That world view, once understood through the perspective of the left pyramid in the diagram shown below, is now better recognized through the expanded pyramid shown on the right.

This evolved view makes it clear that some of what once was judged to be skill can now be captured through exposures to different "smart betas" — factors like volatility, value, size, momentum. Risk premia capture similar effects, but are more appropriately applied

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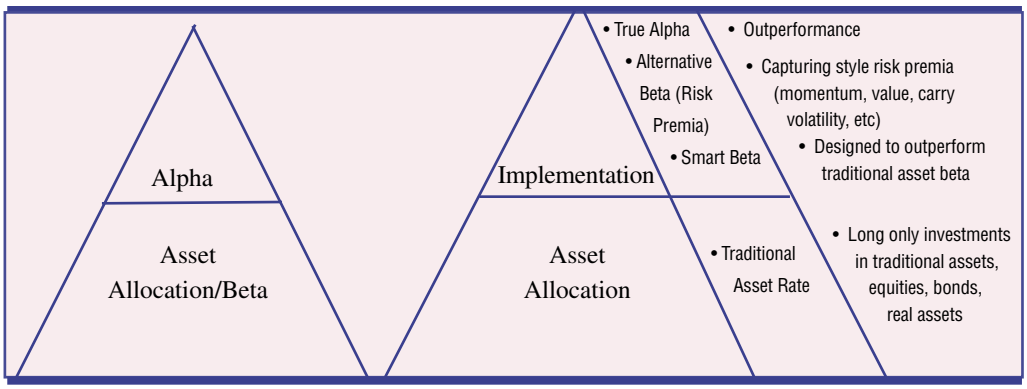

Risk Lenses: The Essential Nature of Risk

By Andrew Junkin, CFA, CAIA

((Continued from page 8)

in the context of hedge funds. "Smart betas" and risk premia can be accessed in liquid, transparent and relatively low cost forms. True alpha is less common than many originally estimated, but is especially valuable as it cannot be recreated and derives from some unique process or skill.

Behavioral Bias

The study of investor behavior has spawned a cottage industry called behavioral finance (and won a Nobel Prize along the way). Much of the work on investor behavior concludes that investors have certain intrinsic biases that create additional hurdles to success. Investors are loss averse — the pain associated with losses is disproportionately large relative to the gratification of similar gains. This creates challenges when markets or active managers aren't performing well as many investors have a natural inclination to make the pain of the poor performance stop. However, as we saw in 2008, the moment of greatest pain is frequently the moment of greatest opportunity. Active managers — even those with true skill and alpha — all underperform periodically as market currents move against them. Terminating at the moment of greatest pain may lead to a vicious cycle of firing managers who have underperformed and hiring managers who have outperformed, only to see the cycle repeat.

Shortfall

Shortfall — the risk that future returns are insufficient to support an asset owner's core mission— could be the most challenging of all the critical risks. While each of the other risk lenses can be mitigated or understood through specific actions, future investment returns are not controllable by investors (or consultants for that matter). While long-term investors could simply load up on risky assets with relatively high expected returns (i.e., equities and private equity), that decision amplifies other critical risks as seen through the risk lenses — namely, drawdown, illiquidity, and investor behavior. While this strategy might solve shortfall in the long run, there could be circumstances (like cash flows, or board turnover, leading to a reevaluation of a long term investment strategy) that make such an approach unworkable or unsuccessful.

And this leads to the most important point: managing one or more of these critical risks creates tension with other risks. Some circumstances will provoke less tension between key risks and an easy balance can be found. However, today's market environment is not currently in a state where asset owners can be protected from large drawdowns, inflation surprises, and illiquidity while achieving double-digit expected returns. Rather, managing risk is an ongoing exercise in judgment as well as a strategic discussion that should drive asset owners and portfolio strategies as well as the communication between boards, consultants, and staffs.

Being aware of the key risks to meeting your organization's mission, and having a plan to address or withstand those risks, is a critical component to the shared goal of sustainability.

Andrew Junkin, CFA, CAIA, is President of Wilshire Consulting in Santa Monica, CA.

Venture Capital: Global Quest for Unicorns

By Kirsten Morin

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Path of innovation

What does the future look like? For starters, we are in the midst of a massive platform shift where consumers and enterprises are shifting away from desktops to mobile. Online speeds are magnitudes above where they were a decade ago thanks to Moore's Law, allowing companies to reach their end customers with speed and ease.

What's more, the global population has come online, meaning that the scale of the opportunity that businesses see in front of them today has multiplied. With a globally connected population, there's also information symmetry. Consumers and enterprises are more fickle and less likely to stay loyal to a brand that isn't offering a best-in-class solution.

As efficiency continues to reduce the costs needed to start a company, we foresee a continued surge in the number of startups that will be created. When it comes to particular segments of innovation, we expect it to be broken down into three core categories.

First, there will be startups targeting established sectors, where they believe they can deliver some level of improvement over the incumbent solutions. Sectors here might include social platforms, e-commerce, entertainment and application development. The second cohort includes companies working to innovate in areas where the perception is that there remains plenty of headroom for new category-leading companies to emerge, or ones developing products for industry-specific verticals. Among others, these include big data, cloud computing, mobile, open source software, security and storage.

Companies have delayed going public in favor of taking on relatively non-dilutive capital from non-traditional venture capital investors. As private investors, the silver lining of companies electing to stay private longer is that the returns accrue to private rather than public market investors.

Lastly, as they always do, entrepreneurs are peering around corners and innovating for what may come in the future. These are the pioneers working to build for what's ahead in machine learning, virtual reality, robotics, bioinformatics, autonomous transportation and the continued penetration of the internet of things.

A celestial quest

Tying back to our global theme, it's important to recognize that anyone, anywhere can test or validate these ideas. No longer do we expect that the best ideas will only come out of Silicon Valley. This multi-dimensional innovation cycle mixed with the increasing pool of global entrepreneurial talent could expand venture capital opportunities available to investors.

But as investors, the search for viable companies and by extension, managers, is no easy feat. As many startups find success, a higher number also fail.

It takes years of company building and operational discipline to decipher which companies might be unicorns in the making, and which are not. With growth stage capital easy to come by in recent years, operational discipline has taken a back seat in favor of the quest for growth.

Companies have delayed going public in favor of taking on relatively non-dilutive capital from non-traditional venture capital investors. As private investors, the silver lining of companies electing to stay private longer is that the returns accrue to private rather than public market investors.

Still, venture capital is a hits-driven business. This means the unicorns that ultimately succeed will have to find a way to become longstanding, profitable enterprises to separate themselves from the overcrowded herd.

It will be these defining companies that drive returns in the upcoming innovation cycle, just as they have in past cycles. It will also be these companies that will continue to drive the vast spread between median and top quartile industry-level returns that are common in venture capital.

This is why we believe access, diversification and an increasingly global approach to venture capital in portfolios could capture the greatest number of unicorns.

Kirsten Morin is a Senior Investment Manager at Aberdeen Global Venture Capital, in New York City, NY.

On the Quest for Returns, Don't Overlook Small-cap Growth

By Douglas J. Levine, CFA

Rising concerns over pension liabilities have led plan sponsors and their consultants to approach portfolio construction with renewed rigor. Yet, for all the recent discussion of relatively modern techniques (such as risk parity and low-volatility strategies), somewhat underappreciated is the benefit of including small-cap growth in plans' asset allocation. Over the long run, having exposure to the most innovative sectors and companies within the U.S. market offers potential diversification advantages and enhanced returns.

Small is Beautiful

Small-cap stocks (those with $3 billion or less in market capitalization) are not just bite-sized versions of their large cap peers, but actually tend to have fundamentally different characteristics. They are more likely to be domestically-oriented and less often rely on debt to finance their operations. So at a time when the dollar is strong and interest rates are expected to rise, small-cap companies could have a relative advantage relative to large caps.

Larger firms that are struggling to grow organically have the ability to consolidate small-cap companies with higher growth profiles. Over the past ten years, approximately 6% of the small-cap universe was acquired with a median premium paid of 25%.[1] In addition, research from Credit Suisse shows that small-cap stocks' valuations relative to large caps' are "the most compelling since the Tech bubble."[2] Such attractive valuations not only allow for multiple-expansion, but could also fuel large cap companies' interest in lower capitalization names.

...due to the heterogeneous nature of the small-cap universe, there tends to be a greater divergence between the "haves" and "have-nots" than in the large cap segment.

Historically, small-cap stocks have also provided fertile ground for active management. While the average large cap stock has more than 20 sell-side analysts covering it, the average small-cap stock has just 6 analysts following it.[3] Moreover, 15% of small-cap stocks are only covered by one or two analysts, while 7% have no coverage at all.[4]

Furthermore, due to the heterogeneous nature of the small-cap universe, there tends to be a greater divergence between the "haves" and "have-nots" than in the large cap segment. For these reasons, the small-cap segment remains inefficient, creating an opportunity for active management to add value.

The Future is Growth

While the above factors are common to all small-cap stocks, there are additional factors unique to the small-cap growth universe. Ultimately, a key distinction between small-cap growth and value asset classes lies in their sector exposures, with technology, healthcare and consumer stocks offering high growth compared to more interest rate sensitive sectors, such as financials, REITs and

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Sector Composition: Small-cap Growth vs. Small-cap Value

	iShares Russell 2000 Growth ETF	iShares Russell 2000 Value ETF
Health Care	28.1%	4.6%
Information Technology	25.1%	10.7%
Consumer Discretionary	16.7%	10.1%
Industrials	12.6%	11.6%
Financials (incl. REITS)	7.8%	43.7%
Materials	4.0%	3.1%
Consumer Staples	3.5%	3.3%
Energy	1.1%	4.4%
Telecommunications	0.8%	0.9%
Utilities	0.1%	7.4%
	100%	100%
Combined exposure to Healthcare, Technology, and Consumer Discretionary	70.0%	25.4%
Combined exposure to Financials, REITS, and Utilities	7.9%	51.0%

While the vast majority of the small cap growth index is comprised of "classic growth" sectors (health care, information technology, and consumer discretionary), just 25.4% of the small cap value index is comprised of these sectors. Conversely, over half of the small cap value index is comprised of lower-growth sectors (financials and utilities).

Source: iShares.com as of December 15, 2015

On the Quest for Returns, Don't Overlook Small-cap Growth

By Douglas J. Levine, CFA

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utilities. Interestingly, over the past ten years, almost 55% of the small-cap acquisitions were in the healthcare, technology and consumer sectors, with a median premium paid of 27%.[5]

For various structural reasons, technology and healthcare companies are benefitting from long-term growth drivers. In these sectors, innovation is not a pipedream, but reality. Today, personalized medicine is revolutionizing healthcare, with biotech research leading to cures for diseases. Technological innovation is no longer just the stuff of futuristic sci-fi movies, but has manifested itself through the Internet of Things, wearables, and unified communications. These advances, along with security, cloud computing and software-defined networks are all disruptors and drivers of growth.

While less of a structural driver and more cyclical, the current strengthening of employment and wage growth, coupled with lower gas prices, could fuel onsumer stocks, which are also a large exposure within the small-cap growth universe.

A Measured Approach

We believe that small-cap growth investing should not be equated with early-stage venture capital investing, or growth-at-any-price strategies. Small-cap growth stocks vary widely in terms of their financial health and other company-specific characteristics, as technology, healthcare and consumer stocks typically have more idiosyncratic fundamental drivers. Small-cap growth companies can often grow market share—and their bottom line— even when the economy itself is sluggish creating further return enhancement opportunity through strong active management. Importantly, growth and disciplined investing need not be mutually exclusive: incorporating a thoughtful approach can drive strong relative returns with lower than market risk over the long term.

Plan sponsors are increasingly searching for better ways to construct portfolios, and innovation should be a part of that exercise. Small-cap growth allows sponsors a time-tested means to harness innovation at the company level.

Douglas J. Levine, is CFA, Managing Director at Rothschild Asset Management Inc. in New York City, NY.

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1 Rothschild analysis using FactSet data, March 2016
2 January in a Nutshell, Credit Suisse, February 2016
3 Rothschild analysis using FactSet data, March 2016
4 Ibid.
5 Ibid.

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August 14 - 16, 2016

28th Annual Conference
Hilton Austin Hotel
Austin, TX
April 9 - April 12, 2017

2017 Summer Educational Forum
Grand Hyatt Hotel
San Antonio, TX
August 13 - 16, 2017

29th Annual Conference
South Padre Island, TX
April 15 - April 18, 2018

2018 Summer Educational Forum
Grand Hyatt Hotel
San Antonio, TX
August 12 - 15, 2018

30th Annual Conference
Hilton Austin Hotel
Austin, TX
April 7 - April 10, 2019

WASHINGTON OUTLOOK

By Matthew Aukofer
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exemption for municipal, or muni, bonds but state and local government groups have lobbied hard to keep it.

State and local government associations are fighting the repeal of the muni bond tax exemption because it likely would lead to higher interest rates. States and localities sell bonds to raise capital, mostly for infrastructure and school projects. Because the investors that buy them don't get taxed on the interest, governments can offer a lower interest rate, meaning it costs less for them to finance their projects.

While many types of municipal bonds offer tax-exempt income, there is an entirely separate market of municipal issues that are taxable. Governmental issuers will sell taxable municipal bonds because the federal government will not subsidize the financing of certain activities that it deems fail to provide a significant benefit to the general public. These types of taxable bond issues can include investor-led housing, local sports facilities and borrowing to replenish a municipality's underfunded pension plan.

A study commissioned last year by the International City/County Management Association and the Government Finance Officers Association, confirmed one argument made in favor of the tax exemption for muni bonds: Since investors don't have to pay an income tax on their interest earnings from the bonds, governments can pay off their bonds at a lower interest rate than they would otherwise. The tax-free status of muni bonds saved governments an estimated $714 billion in extra interest payments from 2000 to 2014, the report found.

To put that in perspective, that's enough money for all of the professional sports cities in the U.S. and Canada to build a state-of-the-art stadium, a ballpark and an arena six times over.

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To put that in perspective, that's enough money for all of the professional sports cities in the U.S. and Canada to build a state-of-the-art stadium, a ballpark and an arena six times over.

But FASAB said it is not the intent of the proposal to single out for attack any of the federal government's tax breaks. It simply wants federal financial reporting to present those tax policies context.

"The financial impact of tax expenditures clearly warrants their disclosure in the financial statements; however, that was not the main driver for this proposed standard," FASAB Chairman Scott Showalter said in a news release.

"The government can and does use tax expenditures as an alternative to other policy instruments — such as spending or regulatory programs — to address and hopefully accomplish policy objectives," he added. "Because tax expenditures are not explicitly reported as appropriations or displayed in the statements of net cost or changes in net position, we need to shine a light on them."

FASAB is requesting comments on the exposure draft of its proposal by Sept. 15.

On the Web at: http://www.fasab.gov/documents-for-comment/, http://files.fasab.gov/pdffiles/taxexpenditures_ed_2016.pdf, http://www.governing.com/topics/finance/gov-what-happens-when-start-taxing-muni-bonds.html, http://www.governing.com/topics/politics/gov-municipal-finance-congressional-caucus.html, http://icma.org/en/icma/knowledge_network/documents/kn/Document/307554/Municipal_Bonds_and_Infrastructure_Development__Past_Present_and_Future?utm_source=pressrelease&utm_medium=email&utm_content=text&utm_campaign=munibonds8-17-15, https://www.cbo.gov/topics/budget.