

December 10, 2009

# **Proposal to Provide Investment Consulting Services**

Port of Houston Authority



## **MERCER**



MARSH MERCER KROLL  
GUY CARPENTER OLIVER WYMAN

Consulting. Outsourcing. Investments.

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## **Title Page**

**RFP Subject:** Request for Proposal for Pension Investment Consulting Services for the Port of Houston Authority Pension Plan

**Name of Proposer's Firm:** Mercer Investment Consulting, Inc. (Mercer)

**Telephone/Fax Number:** 214-220-3540/214-220-6250

**Contact Person:** Eddie Guerra

**Firm Founded:** Mercer was founded in 1972

**Proposal Prepared:** December 1, 2009

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**3****Letter of Transmittal**

Curtis R. Rose, CPM, APP  
Purchasing Manager  
Port of Houston Authority  
Executive Office Building  
111 East Loop North  
Houston, Texas 77029

**RE: Request for Proposals for Pension Investment Consulting Services for the Port of Houston Authority Pension Plan**

Dear Mr. Rose:

Mercer is pleased to submit the attached proposal in response to the RFP for investment consulting services for the Port of Houston Authority Pension Plan (Port Authority). Mercer is a full-service investment consulting firm offering a complete range of investment consulting services, from developing and implementing investment strategies to evaluating investment activities and results of total program.

As described in the RFP, the Port Authority is seeking an investment consultant for its defined benefit plan (the "Plan") with assets of approximately \$93 million. It is our understanding that the Port Authority is requesting full service retainer services for the Plan including asset allocation recommendations with quarterly updates, investment policy review, manager selection and recommendations, performance monitoring and educational assistance to the Pension Committee on relevant investing and pension issues. Based on the RFP this proposal presents our approach to the services the Port Authority requires.

Mercer's mission is to help clients succeed by delivering the best consulting services. We are committed to doing this through our resources, processes, research analytics and tools. Our competitive advantages include our:

**Resources** – Since 1972 we have grown to become one of the largest investment consulting organizations in the world by focusing on each individual client within each market. Clients benefit from our ongoing investment in research staff and analytical tools, which focus on asset allocation, performance evaluation and risk management.

**Significant Public Defined Benefit Plan Investment Consulting Experience** – Mercer has extensive experience providing comprehensive consulting to public defined benefit plan sponsors. We work with some of the largest public plans in the US. Mercer leverages our work experience and marketplace presence to be thought leaders in the industry and deliver the best customized investment consulting services possible. Over the last three years, we have witnessed significant growth in our public plan business and partner with a number of state retirement systems. In the US, Mercer has 26 public defined benefit retainer clients with over \$463 billion in assets under advisement.

**Research Capabilities** – We devote 10-15% of our annual revenue to technology and investment research on asset managers and the capital markets to make critical recommendations to our clients. Over 70 full-time manager research professionals analyze investment managers in their respective markets to pinpoint the strategies that we believe have the potential to offer our clients superior risk-adjusted performance.

**Thought Leadership** – We keep our clients apprised of issues within the capital markets, both through on-going interactions and with white papers, perspectives and surveys throughout the year. Mercer's US Investment Policy Committee is composed of senior consultants who discover opportunities to enhance our thought leadership and to examine how to improve client results. For an introduction to our positions on relevant issues, please access the following site: [www.mercer.com/pensionrisk](http://www.mercer.com/pensionrisk).

**Quality Assurance** – We ensure the quality and accuracy of our consulting advice and services through a formal system of professional standards. All work that Mercer performs for clients is peer reviewed by a second senior consultant to help ensure its accuracy and appropriateness. During the first year of our relationship we will conduct a client satisfaction survey with Port Authority to determine if we are meeting your goals and how to improve our services

**Focusing on Fiduciary Obligations** – We understand that the fiduciary environment has changed drastically over the last few years. As a registered investment advisor Mercer is a fiduciary with respect to the investment advice we provide, which we will acknowledge in writing.

As principal I am authorized to make representations for Mercer. We have reviewed the Port Authority's form contract and have proposed some modifications. Our list of exceptions and proposed modifications is attached in the appendix. If you have any questions please feel free to contact me or the proposed lead consultant, Eddie Guerra. We would be happy to meet with you to review our capabilities in greater detail.

Thank you for considering Mercer.

Sincerely,



Guy Cooper  
Principal  
4400 Bank One Center  
Dallas, TX 73201  
214 220 6252

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## **Responses to Detailed Questionnaire**

### **A. Your firm**

**1. Provide a copy of your ADV as filed with the SEC.**

Please see the appendix for our most current Form ADV.

**2. Describe all past, present, and pending censures by the SEC.**

Not applicable, Mercer has never been censure by the SEC.

**3. Describe any past, present, and pending criminal, civil or administrative litigation against your firm.**

In the ordinary course of business, Mercer is involved with litigation and other legal proceedings, investigations, and inquiries, some of which are conducted on an industry-wide basis. The outcomes of currently pending litigation, investigations, and inquiries are not expected to have any material adverse effect upon Mercer or its ability to service its clients.

**4. Describe the ownership structure of your firm. If employees have an ownership interest in the firm, please specifically identify who holds that interest.**

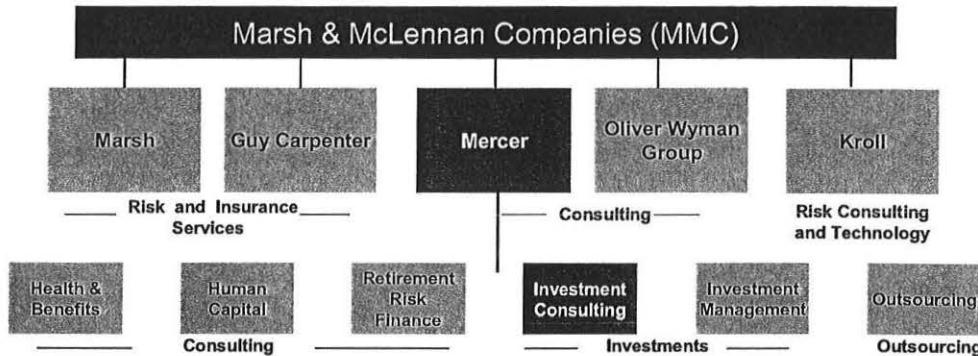
Mercer is an operating unit of Marsh & McLennan Companies, Inc. (MMC). In the US, the investment consulting business is operated through Mercer Investment Consulting, Inc., a wholly-owned subsidiary of Mercer (US) Inc., a wholly-owned subsidiary of MMC.

Mercer is the global leader for trusted HR and related financial advice, products, and services. The company has specialist expertise in all areas of human resource consulting, including compensation, employee benefits, communication, and human capital strategy.

MMC is a global professional services firm with annual revenues of approximately \$11 billion. As of December 31, 2008, approximately 54,000 employees provide analysis, advice, and transactional capabilities to clients in over 100 countries. It is the parent company of Marsh, the world's leading risk and insurance services firm; Guy Carpenter, the world's leading reinsurance intermediary; Kroll, the world's leading risk intelligence

company; Mercer, a major global provider of human resources and investment consulting services; and, Oliver Wyman, a global provider of specialty consulting services. Its stock (ticker symbol: MMC) is listed on the New York, Chicago, Pacific, and London stock exchanges. MMC's website address is [www.mmc.com](http://www.mmc.com).

Below is a diagram of MMC's operational structure for the US:



- 5. If any changes in firm ownership are being contemplated, please provide details on the contemplated changes.**

To our knowledge no changes in firm ownership are being contemplated.

- 6. How long has your firm been in business?**

Mercer has been in business since 1972.

- 7. Provide the most recent audited financial statement for the firm, including a balance sheet and income statement.**

Please see the appendix for our latest annual report.

- 8. Provide a description of the types and amounts of insurance coverages.**

Mercer is covered under a comprehensive insurance program designed by our parent company, MMC. The insurance program provides limits of coverage that meet or exceed usual and customary standards of insurance for similar firms insuring similar risks.

Mercer currently maintains the following insurance coverage:

- Errors and Omissions (E&O) (aka Professional Liability) -- The company's professional liability insurance coverage is provided by Epsilon Insurance Company, with liability limits of \$10,000,000 per claim.
- Commercial General Liability – Mercer's commercial general liability coverage has limits of liability of \$2,000,000 combined single limit per occurrence and \$4,000,000 in aggregate.
- Automobile Liability -- Mercer's automobile liability coverage for owned, hired and non-owned vehicles has limits of liability of \$5,000,000 combined single limit per accident for bodily injury and property damage.

- Workers' Compensation and Employers Liability -- Mercer maintains workers' compensation coverage as required by state law and Employers liability limits of liability of \$2,000,000 per accident.
- Fidelity Bond -- Mercer's Fidelity Bond coverage is provided by Vigilant Insurance Company with liability limits of \$10,000,000 per loss.

**9. Provide an organization chart for your firm. Show the total number of employees in each section of the organization chart.**

Below is an organizational chart of our US investment consulting business showing the consultants, researchers and technical groups as well as their locations as of September 2009.

<b>Consulting</b>			
<b>Leadership</b>			<b>Consulting Specialists</b>
Americas Business Leader Jeff Schutes	Manager Research	Northeast Zone	Corporate Cash - Terry Dennison
US Director of Consulting Terry Dennison	Boston Catherine Beard Brian Clark Carey Freimuth Kriston Goodman Steve Jones Jennifer Koelle Carrie Liebovich** Marilyn Link Jack Liu David Nix Alan Papier Mark Phelps Hoa Quach Michelle Reuter Evan Scussel David Smithwick Byron Willey Peter Willett Allison Yager	Gen Carroll David Eisenberg Liana Magner Susan Rowley Jill Walker New York Joe Barone Makaiya Brown Bob Burke Steve Case Angel Haddad Rashid Hasan Aruna Jain Andrew Kramer Amy Labanowski Thysso Pizzoferrato Beth Ripiton Princeton Mike Kaplan Doug Kresz Chip Rosenthal	Los Angeles Marina Battwalla Susan Dalton Tom Lightfoot Devon Muir Ursula Niederberger Alan Parkh Linda Suzuki San Francisco Toni Brown Ellen Dempsey Richard Faw Diana Greenstone Eileen Kwei Michael Tadlock Seattle Asad Ali Troy Saharic Christopher Tauber David Williams
Directors		Midwest Zone	<b>Specialty Services</b>
Operations - Scott Freeman Marketing - Andrew Kramer Technical Products & Services - James Gordon	Chicago Edgar Alcantara Edward Card Neil Cornell Christopher Ebersole David Frahm Brian Frick Ryan Gould Scott Jarboe Guhann Kannan David Kelly Youngmi Lee Vincent Mok Mick Moloney Debra Nica Andre Tapernoux Gordon Young	Kristin Finney-Cooke Micah Fannin Louis Finney Patty Hafner Paul Kirby Doug Kryscio Joe Libbra Jordan Nault Kweku Obed Lanea Pranger Jeff Schutes Patrick Silvestri Philip Suess	Analytics, Research & Tools Financial Strategy Mercer Sentinel® Responsible Investing Annuity Settlement Market Business Leader
		Atlanta Scott Abel David Axelson Jeff Boucek Kelly Henson Jay Love John Nussbaumer Keith Reynolds Milam Tolbert Dallas Guy Cooper Eddie Guerra Richmond Marshall Martin Andrew Noss Washington DC Mary Pat Alcus Nick Davies	John McSherry Paul Sachs Stacy Scapino Freeman Wood Jane Ambachtsheer Craig Metrick Karen Ambrose **Part time
			As of September 2009

**10. Provide a copy of your firm's equal employment policy, HUB, Small Business or similar policies and goals.**

Mercer (US) Inc. is an "Equal Opportunity Employer" as contemplated by Title VII of the Civil Rights Act of 1964, as amended, and by all other appropriate federal, state and local laws. It is Mercer's policy to apply the same ingenuity, dedication and effort used in solving complex business problems to the task of affirmatively providing equal opportunity for employment and advancement without regard to race, color, religion, sex, national origin, age, marital status, sexual orientation, gender identity, citizenship, real or perceived disability or handicap, genetic predisposition, status as a Vietnam-era veteran, special disabled veteran or other veteran who served on active duty during a war, campaign or expedition for which a campaign badge has been authorized (campaign badges are awarded to military service members who participate in certain campaigns or expeditions; a full list is available at [www.opm.gov/veterans](http://www.opm.gov/veterans)), and/or any other protected category in accordance with applicable federal, state or local laws.

It is also the intention of this policy that all Mercer offices extend the requirements of the policy to include all additional categories of individuals protected against discrimination under applicable local, municipal, county or state legislation or regulation.

## Commitments

Consistent with and supportive of this policy, Mercer is dedicated to:

- Take affirmative action to employ and advance in employment women, minorities, disabled individuals and covered veterans
- Implement and monitor this policy, and report regularly on progress achieved to Mercer's Chairman
- Recruit, employ, train, and promote persons for all job classifications without regard to race, religion, color, sex, age, disability, national origin, marital status, Vietnam-era or other covered veteran status, sexual orientation or citizenship
- Base employment decisions only upon an individual's qualifications for the essential functions of the position being filled
- Contact sources of employees to increase the number of qualified female, minority, disabled and Vietnam-era or other covered veteran applicants
- Make reasonable accommodations consistent with applicable law to enable an otherwise qualified individual with a disability to successfully perform the essential functions of a job
- Base promotion decisions only on an individual's job performance, experience, abilities, skills, and interests in relation to the essential functions of the position being filled
- Ensure, when all other things are equal, that other personnel actions and programs (including, but not limited to, compensation, benefits, transfers, recruitment, terminations, layoffs, company-sponsored training, tuition reimbursement and social and recreational programs) are administered without regard to race, religion, color, sex, age, disability, national origin, marital status, Vietnam-era or other covered veteran status, sexual orientation or citizenship
- Determine the extent to which tests are utilized so that they are job related and predictive of performance
- Encourage all qualified employees, particularly minorities, women, the disabled and Vietnam-era and other covered veterans, to participate in education and training courses within and outside of Mercer, and to encourage all employees to train for more highly skilled positions available at Mercer
- Communicate fully to all managers, supervisors, and all employees that providing equal employment opportunity for all is not only a requirement of the law but also a goal to which we wholeheartedly commit ourselves
- Implement this policy in accordance with Mercer's "at-will" employment policies, since nothing stated in the policy is intended to serve as an employment contract or guarantee of continued employment
- Comply with Federal Record Retention Requirements set forth by the federal government

**11. Describe the types of compensation available to your professional staff, especially any type(s) that would apply to the team covering this account.**

Compensation for Mercer consultants consists of a base salary and an incentive award program. The incentive award amount is based upon Mercer's success against its financial and other business objectives and the achievements of each individual professional. Our firm sets annual goals for revenue and profit growth. If the firm achieves these goals, the program designates an incentive pool of funds. Incentive awards at the individual level are contingent upon individual achievement of objectives set at the beginning of each year. These objectives include, but are not limited to, client satisfaction responses and success in retaining existing clients and new business development. The program is intended to foster both cooperation and individual achievement.

In addition to traditional compensation, senior professionals are awarded stock options that vest over four years and are exercisable over a period of 10 years, but only contingent upon continued service. All employees may participate in equity ownership through our parent company's qualified employee stock ownership plan, and may also purchase MMC stock at a discount through a separate, non-qualified Stock Purchase Plan. Also, senior professionals may defer their incentive payments and elect to invest such deferrals in company stock. And, the incentive bonus program itself encourages employees to remain with the company in order to receive each prior year's distribution. Finally, senior professionals are bound by non-solicitation agreements that we believe limit their ability to "take their clients with them" in the event of an unforeseen departure from Mercer.

**12. What is the total number of clients being served by your organization?**

As of December 31, 2008, within the US, Mercer's investment consulting business had 326 retainer client relationships with approximately \$1 trillion in assets under advisement.

**13. Have you placed a limit on the number of clients your organization will serve? If yes, please provide that limit.**

Although we have a large client base across our global investment consulting business, we have a focused growth strategy in terms of the number of clients that we can service. This growth strategy has been very successful as it enables us to allocate the appropriate resources and develop dedicated consulting teams which add significant long-term value to our clients' investment programs, while maintaining exception client servicing. The team that would be assigned to partner with the Port Authority on this assignment is selectively adding new clients each year which will make certain that your organization receives the dedicated attention that is needed for this assignment.

**14. What is the largest number of clients handled by one team?**

We do not place a formal limit on the number of client relationships any consultant may lead. Each client has different needs and complexities and, as a result, may require more or less time from their consultant. Senior field consultants generally lead no more than 10-12 relationships. Overall, our ratio of retainer clients to investment professionals is less than 7:1.

Rather than place explicit limits based on the number of clients, utilization levels for individual consultants are reviewed on a monthly basis. In cases where utilization is too high relative to target, we review the consultant's workload. If no immediate reduction in workload is anticipated, e.g., due to completion of specific short-term projects, we will consider curtailing the consultant's involvement in pursuit of new business until such time as the issue is remedied. This is true for professionals and support staff at all levels, not just for our lead consultants.

- 15. How many government accounts does your firm service? How many accounts with Texas governmental agencies does your firm service? Are there differences between governmental pension plans and private sector pension plans which you believe are relevant to asset allocation or investment management?**

As of December 31, 2008 we had 49 government clients with over \$804 billion in assets under advisement. We currently consult to one Texas governmental agency.

Mercer has undertaken a series of studies related to the level of investment risk that is appropriate for public plan sponsors. Our analysis has focused on the concept of a "Pension Event Horizon", which is the point where the plan's unfunded liabilities cannot be satisfied by sustainable contributions or investment returns. We defined the Pension Event Horizon as the ratio of unfunded actuarial accrued liability (UAAL) to payroll contribution where there is no reasonable probability that the UAAL can be funded over a foreseeable time horizon. This ratio varies depending on a number of factors, including the size of the plan relative to the payroll base or the tax revenue base of the sponsoring entity and the maturity of the plan.

The outcome of this analysis is that public plan sponsors should relate the riskiness of their investment program to their plan characteristics and payroll and tax revenue base. This is an interesting but complex area of analysis. Mercer would be very happy to have the opportunity to investigate the implications of this type of analysis for the Port Authority.

- 16. Describe any relationships with the Port Authority's employees, Commissioners, trustees or others that may be construed as a conflict of interest as defined by ERISA (as if ERISA were applicable to the Plan), Chapter 802 of the Texas Government Code, or the provisions of Texas law concerning public officials pursuant to Chapter 171 of the Texas Local Government Code.**

To our knowledge Mercer does not have any relationship with the Port Authority's employees, Commissioners, trustees or others that may be construed as a conflict of interest.

- 17. Provide information explaining your procedures for maintaining independence in the advice that you, as pension investment consultant, provide, in light of the fact that many pension consulting firms provide services both to pension plans who are their advisory clients and to money managers, which duality may create a conflict of interest potentially clouding objectivity.**

Mercer is a business unit within MMC, a Fortune 500® company. MMC is a large, diversified financial services company, which employs approximately 55,000 employees across more than 100 countries and territories. Mercer's investment consulting business itself serves more than 1,700 clients across more than 40 countries.

As such, certain investment managers whose strategies are rated, reviewed, or recommended by Mercer may, in the ordinary course of business, also be clients, or affiliated with clients, of Mercer or its affiliates. Mercer may sell certain software and other services to investment management firms. These relationships have no connection with Mercer's research or recommendations of investment managers to clients.

In the US, Mercer's services to investment managers and their affiliates primarily consists of traditional investment consulting services, which typically relate to the assets of the firm's retirement plans; or the evaluation of subadvisors for mutual funds or separately managed wrap accounts for retail or high net worth clients. The proportion of our revenue derived from these activities is small.

Mercer believes it has taken appropriate steps to minimize or eliminate the likelihood that its recommendations of investment managers to clients will be influenced by other business relationships those investment managers or their affiliates may have with Mercer or its affiliates. Among other things, Mercer has taken the following steps to address these potential conflicts:

- Mercer's manager research and selection activities follow a defined process that includes evaluations by its Ratings Review Committees worldwide and the documentation of findings and decisions. At no time during the rating or selection process is the status of a manager or its affiliates as a consulting client of Mercer or a client of its affiliates considered.
- None of Mercer's manager research staff receive any form of compensation that is directly linked to services provided to managers or their affiliates. Compensation is linked to the overall business results of Mercer and its parent company, and, in the case of the Manager Research staff, to the performance of the ratings and recommendations made by Manager Research.
- If a subscription to Mercer's software or forums is sold to an investment manager client, the client is specifically told that its purchase will not result in any preferential treatment by Mercer in its evaluation or selection of any investment product.

**18. Describe your business relationships (and those of your affiliates), including but not limited to receipt of fees, from money managers that you would recommend to Port Authority.**

Please see the response to the previous question.

**19. Describe the extent to which you will disclose conflicts and potential conflicts of interest to Port Authority. Of particular interest are your business relationships with money management firms that you would consider recommending to Port Authority.**

As discussed in question 17 and 22 we have implemented policy and procedures to prevent and disclose any conflicts or potential conflicts of interest. We update our Form ADV on an annual basis and provide the updated forms to client by request. Please see the appendix for our most current Form ADV.

20. **Describe the extent to which you will, and the method you will use to, disclose conflicts and potential conflicts of interest which you know or discover between yourself (and your affiliates) and the pension plan trustees, including any economic benefits provided directly or indirectly from plan service providers.**

Please see the response to the previous question. Mercer does not accept soft dollar issues bills directly to clients, and does not accept soft dollar payments for services.

21. **Explain in detail your understanding of the fiduciary relationship, if you are awarded the contract, between yourself as pension consultant and the Port Authority as your client.**

As an SEC-registered investment advisor, Mercer is a fiduciary with respect to the investment advice we provide clients. ERISA and related Department of Labor regulations define certain investment advice as being ERISA fiduciary in nature. Mercer's acceptance of such ERISA fiduciary status, if applicable, would be solely with respect to our role as an investment advisor. Our responsibility would not include discretionary control of the Plans or their assets. We would have no responsibility for the actions or advice of investment advisors or service providers other than Mercer.

As an ERISA fiduciary with respect to the investment advice we provide to the Port Authority, we are responsible for providing that investment advice with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. We are also required discharge our duties with respect to our client's retirement plan for the exclusive benefit of the plan and its participants.

22. **Describe the policies and procedures maintained by your company that concern how you prevent and manage conflicts of interest in your pension consulting activities.**

Mercer is a business unit within Marsh & McLennan Companies, Inc. (MMC), a Fortune 500® company. MMC is a large, diversified financial services company, and as such potential conflicts of interest are inherent in its many businesses. As an overall policy, Mercer monitors its business for potential conflicts of interest and attempts to assess them objectively. Mercer has established a conflict assessment process as follows:

- When a conflict of interest is identified, Mercer assesses the severity of its potential impact under various scenarios, including the potential for the conflict to result in improper behavior by an employee or to create an appearance of impropriety.
- If, after the risk assessment, Mercer is satisfied that the conflict can be managed without hindering the objectivity of the advice we provide to our clients, we establish and enforce management structures and procedures designed to address the conflict in a way that avoids any reasonably foreseeable adverse effect.
- Mercer monitors those operations where conflicts may occur to make certain that our management structures and procedures are being properly enforced, making modifications when appropriate.

The ultimate protection against the inappropriate influence of conflicts of interest is the integrity of our staff and the understanding that, as in any consulting organization, our

reputation is our most important asset. This concept has been nurtured and reinforced over the years and is embedded in Mercer's culture.

Mercer provides regular employee training sessions designed to educate our consultants as to the importance of identifying, disclosing and properly managing conflicts of interest. Mercer has a Compliance Manual that details all of our consulting policies and procedures. Strict adherence to both the Compliance Manual and the CFA Institute® Code of Ethics & Standards of Professional Conduct is required of all Mercer staff.

Finally, Mercer issues bills directly to clients and does not accept soft-dollar payments.

#### **Mercer Investment Affiliates**

As part of MMC, Mercer is affiliated with an investment business, Mercer Global Investments, a provider of investment management services (an outsourced, manager of managers approach) for institutional clients. We have integrated investment management with investment consulting (including our manager research and performance monitoring expertise) to create effective outsourced solutions for clients. Using our Investment Discretion and Advisory Services (IDAS) platform, Mercer assumes fiduciary responsibility for the selection and monitoring of investment managers on the plan sponsor's behalf.

- 23. Describe the policies and procedures maintained by your company that govern disclosure of conflicts to existing and prospective advisory clients.**

Please see the response to question 17, 19, 22.

- 24. Describe the policies and procedures maintained by your company to prevent conflicts of interest or disclose material conflicts of interest with respect to the use of brokerage commissions, gifts, gratuities, entertainment, contributions, donations and the like provided to clients or received from money managers.**

Mercer does not accept brokerage commissions. We issue bills directly to clients and only accept payments in hard dollars. We have a strict gifts and entertainment policy and donations and contributions from money managers or provided to clients are prohibited.

At Mercer, integrity is one of our core values and is engrained in our culture. Mercer's compliance program is designed to uphold this value by supporting the prevention, detection and correction of any violations of applicable laws, Mercer policies and other ethical obligations. To accomplish this, Mercer maintains relevant policies and procedures, offers colleagues applicable training, and regularly monitors the adequacy and effectiveness of our compliance program. Additionally, all Mercer employees are required to adhere to the Code of Business Conduct and Ethics of our parent company, Marsh & McLennan Companies, Inc.

Compliance at Mercer is overseen by the Compliance & Professional Standards group. Our corporate Chief Compliance Officer, a member of the company's Operating Committee, leads the compliance function. Senior members of the function are assigned oversight responsibility for each line of business and geography in order to maintain and support a culture of integrity and excellence.

## B. Your Services

1. Do you perform asset allocation studies? If yes, describe your method for developing an asset allocation, and provide references, including contact information, for at least two organizations for which you have provided such service. The references should be from organizations that have total assets of a magnitude similar to the Port Authority pension fund.

Mercer has extensive experience performing asset allocation studies. In the US we have conducted 391 strategic asset allocation studies for clients over the last five years (2004-2008). We believe that assets should be invested with a complete understanding of the interactions between assets, liabilities, and the sponsor – in this case the government and taxpayers of Port Authority. A proper asset/liability study brings into focus the relationships between all three parts of the plan. As such an asset allocation study is typically performed in conjunction with an asset liability study. Please see the response to question four for detailed information on our asset allocation methodology and references.

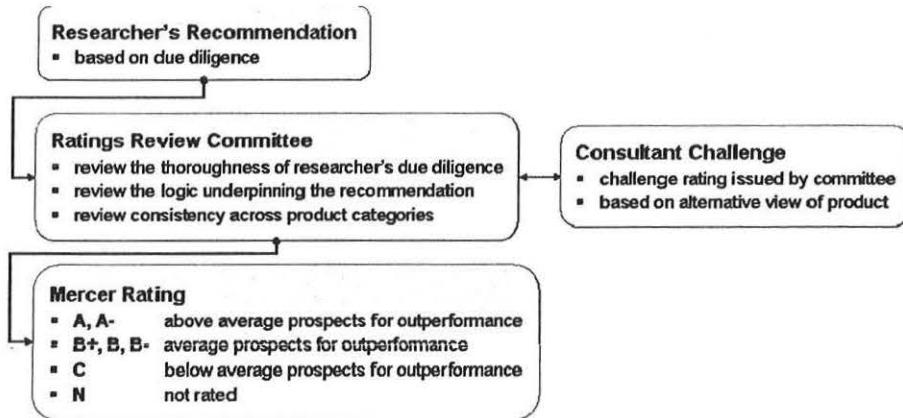
2. Do you provide recommendations for investment managers? If yes, provide the method by which you determine which managers are to be recommended.

Our formal ratings review process helps to ensure a high-quality selection of managers for the search process and for the continual evaluation of client portfolios. Our objective is for each strategy to outperform its benchmark on a risk-adjusted basis over the next three to five years.

To help accomplish our objectives, we have implemented a number of Ratings Review Committees (RRC) to cover strategies worldwide. Each committee is comprised of selected senior field consultants and research consultants, who are responsible for establishing and monitoring strategy ratings. Each strategy in our database is judged on rigorous quantitative screening criteria and a qualitative assessment by this experienced, senior group. In conjunction with the US Ratings Committee, the International Ratings Review Committee (IRRC) comprises of senior manager researchers and investment consultants drawn from our Australia, Canada, UK and US offices.

Each committee holds quarterly conference calls to review all ratings for their respective strategies. We also discuss the performance of our "A" rated managers against performance expectations given the market environment. Additional calls are held in between quarterly conference calls depending upon circumstances that warrant our immediate attention.

The model below demonstrates the process we follow to arrive at an appropriate rating.

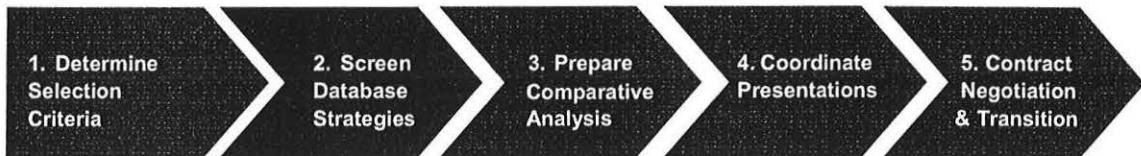


Note that, within the rating categories, we also have several degrees of confidence as noted by a plus (+) and minus (-) to further refine our opinion on a particular strategy.

Products given the highest rating – “A” – are those recommended for searches. During the manager search process, a client’s consultant generally works directly with the research consultants to select from the list of “A” rated products based upon the specific client mandate. The selected subset of “A” rated products comprises the initial candidates in an investment manager search.

## Search Process

Our manager selection process is best depicted by the diagram below:



1. We begin the manager search process by working with clients in order to determine appropriate manager selection criteria. Many clients wish to participate in the initial meeting with the research consultants to discuss potential candidates and how they might fit within the existing portfolio structure. Specific issues discussed include:
    - Asset size and vehicle type
    - Degree of alpha potential and tracking error
    - Degree of correlation with other managers (to provide diversification)
    - Separate client guidelines
    - Cash flow requirements and fee sensitivity
    - Emerging manager, minority-, or female-owned firm preferencesDuring this stage we can include any managers that your Investment Committee wishes to include in the search process.
  2. Products given the highest rating – “A” – are those recommended for searches. During the manager search process, a client’s consultant generally works directly with the research consultants to select from the list of “A” rated products based upon

the specific client criteria as determined in Step 1. The selected subset of "A" rated products comprises the initial candidates in an investment manager search.

3. After managers are selected, a comparative analysis report is reviewed which includes an analysis of various return/risk metrics over multiple time periods, qualitative summary of the manager's investment process and key observations and statistics on the organization.
4. Once finalists are selected, we coordinate presentations including dates and times, presentation agenda's and facilitate the entire process.
5. The final component, one that is sometimes overlooked until late in the process, is the logistics of the transition process. We work with a variety of clients in this capacity – from clients who wish to handle the transition process internally to clients who prefer that we handle the logistics of transitioning from one manager to another. We also help clients negotiate fees based upon our experience.

Throughout this process, we incorporate client staff into these steps based on the client's preference. Many clients wish to participate in the initial meeting with the research consultants to discuss potential candidates and how they might fit within the existing manager structure. Additionally, we occasionally conduct semi-finalist interviews, either on-site or at the client's location, in order to condense the list of finalists presented to the client.

**3. Describe your due diligence process when conducting an investment manager search.**

Our research process involves a combination of on-site visits to investment managers, statistical analysis, and the direct experience of our consultant teams who are responsible for establishing our view on each investment manager. In 2008, we held more than 2,750 investment manager research meetings worldwide, including more than 1,300 meetings in the US. Globally, more than 100 field consultants meet with managers periodically.

For on-site meetings, we meet with portfolio managers, analysts and traders to assess the merits of the strategy on a forward-looking basis. We focus on the drivers of past and future performance.

Our research consultants evaluate an investment strategy both quantitatively and qualitatively. Initially, they analyze all strategies using a quantitative review process to gauge whether performance resulted from skill or luck. We also perform detailed, quarterly performance attribution analysis on all of our clients' managers, customized to meet their needs and requirements.

#### **Qualitative Review**

During an onsite visit, our research consultants conduct a detailed review of the manager's organizational structure, meet with key decision-making personnel, review the investment process and procedures, evaluate resources available to the professional staff, review compensation practices and ownership structure, and identify communication methods used to share ideas and information.

In evaluating investment managers, we analyze a full range of factors starting with how investment ideas are generated by the manager to the ultimate implementation of those ideas. Embedded in our process is an in-depth evaluation of firm-wide issues that have a major impact on how well the investment team functions within a specific firm environment.

We believe that these factors encompass the qualities that investment managers need to be able to do well in order to have strong prospects for outperforming. Each of these factors are rated as either Negative (-), Neutral (=), Positive (+) or Very Positive (++) . Our overall strategy ratings are derived based on an overall research opinion. They do not represent a weighted average of the four factor scores.

The four factors correspond to a set of four core beliefs about the key drivers of investment performance as follows:

Factor	Core Belief
Idea Generation	In order to outperform, a manager must be able to generate value-adding investment ideas. It is the quality and breadth of these ideas that are key drivers for long term success.
Portfolio Construction	The quality of a manager's portfolio construction process will determine how effectively its value-adding investment ideas are converted into consistent outperformance. Key elements are how well the manager calibrates active positions in the portfolio, the extent to which these reflect the manager's highest conviction ideas and how well they manage risk.
Implementation	For a manager to outperform, the value added through its investment ideas and portfolio construction process must outweigh the drag on its performance due to transaction costs.
Business Management	Well managed investment firms are more likely to maintain and enhance the competitiveness of their investment strategies over time than poorly managed firms.

Following the meeting the research consultant writes a research note which is then peer reviewed by another researcher. If a researcher believes a change in a strategy's rating is warranted, a detailed analysis supporting the recommendation is prepared and then brought before the relevant Rating Review Committee (RRC). The recommendation is discussed and all rating changes are approved by a majority vote of the RRC.

### Quantitative Review

We focus on many different quantitative measures, including the following measures that we feel are critical to understanding manager performance:

- **Alpha** (the excess return the manager historically added over an appropriate benchmark) measures whether the manager has skill in managing assets in a particular asset class. We also evaluate down-market alpha, or a manager's ability to add value in down markets to help clients gauge how well a manager protects assets in a declining market.
- **Batting average** measures the percentage of time a manager outperformed its benchmark over a given period, thus indicating performance consistency.

- **Sharpe ratio** measures the degree to which volatility of performance is compensated by additional return. A higher Sharpe Ratio means that the manager is achieving greater performance per unit of volatility (i.e., risk). We analyze both historical and expected Sharpe ratios. We relate a strategy's Sharpe ratio to its stated objective in order to ascertain if the investment process meets client expectations.

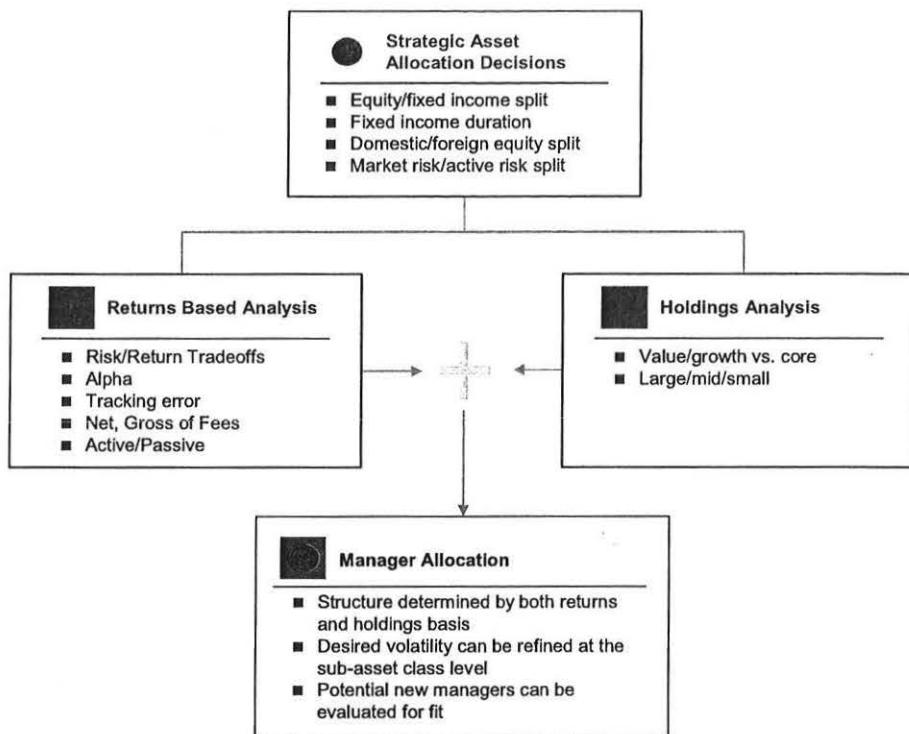
We employ several tools to assist in our evaluation of a strategy's return/risk characteristics.

- **Manager Performance Analytics (MPA<sup>®</sup>)** provides analysis on a variety of measures including: excess return over rolling time periods, risk characteristics (tracking error and standard deviation), returns consistency, information ratio, confidence of value added, correlation of returns analysis, and performance in up/down markets. This system evaluates a strategy's performance and risk characteristics relative to its appropriate peer group (large value, large growth, large core, etc.) and benchmark.
- **Style Research Portfolio Analyzer** provides a clear view of a single or combined portfolio's composition with respect to the style factors influencing performance in each market. This software package enables us to analyze portfolios at the security level.

4. **Do you perform asset/liability studies? If yes, describe your asset liability model in detail and indicate if the model is proprietary or purchased. State how often you recommend performing an asset/liability study. Provide references, including contact information, for at least two organizations for which you have performed an asset/liability study. The references should be from organizations that have total assets of a magnitude similar to the Port Authority pension fund.**

As stated previously asset allocation is typically performed in conjunction with asset/liability study. Our approach to asset allocation recognizes that all clients are subject to the same capital markets, but they have different investment problems to solve and different levels of comfort with the markets. As a result, the goal of our strategic asset allocation an investment policy work is to find the best intersection of the outlook for the capital market with the client's unique goals circumstances and constraints. The outcome is a unique set of client specific solutions, each built from the same core intellectual capital. To achieve this we work collaboratively with clients, establishing the interactive and creative approach that underlies all our consulting relationships. This approach includes:

- **Strategic asset allocation** – allocation among high-level asset classes
- **Portfolio structuring** – allocation among sub-asset classes to ensure proper diversification
- **Manager selection** – evaluation of manager performance in order to determine one suitable for a client's requirements



The process begins by collecting and analyzing key information, including plan goals/objectives, contribution/benefit payment policies, funded status, risk posture, and return expectations. During this process, we work closely with our asset/liability modeling group comprised of licensed actuaries who employ a series of proprietary software models to develop customized analytics.

After our analysis is complete, we present our findings and work with clients to evaluate the trade-offs in policy decisions by comparing key financial metrics.

### Public Fund Experience

Most public funds focus on the trade-off of providing lower contributions while simultaneously making them as stable as possible. On a purely economic basis, the long duration of the liabilities should be matched up with a long, high quality bond portfolio. However, standard actuarial practices does not mark the liabilities to market--in particular, a static discount rate obscures the market value. Thus, the advantages of longer bonds aren't directly observable and only become apparent over the long run. (A short term analysis of one or two years could show greater variability of contributions with long bonds).

Another element that distinguishes many public plans is cost-of-living increases tied to inflation. In this case, TIPS can be very helpful in lowering contribution volatility.

Finally, many public plans are entering their "mature" stage: benefit payments exceed contributions; thus, liquidity needs are beginning to increase. Additionally, the size of the plans means that a downturn in the equity market can cause unfunded liabilities to increase by billions of dollars. Such plans should take on a more conservative posture to lower contribution volatility.

In order to address the issues stated above, Mercer leverages its vast actuarial knowledge, integrated with proprietary software tools to customize solutions for our clients.

As each plan is unique, the most important factor in asset liability modeling is an understanding the liabilities. We ask several questions to develop a clear understanding of the plan and its liabilities. These include:

- What is the split between active and inactive liability? Is there an early retirement window? What are the lump sum options?
- Is there an automatic cost-of-living increase, which makes the plan liabilities sensitive to inflation?
- Are the benefit formulas contingent on something other than salary, age, and service? For example, we have seen plans that have automatic benefit increases if the plans become 120% funded (which did happen in the late 1990s).

Once the demographics are correct, it is important to model contribution policies correctly or at least have the flexibility to model different contribution scenarios since many sponsors are choosing to forego their full contributions due to budgetary considerations. We use both stochastic and deterministic modeling in our approach.

### Our Models

In order to understand the range of outcomes, we employ an economic model of capital markets (CMS) to focus on three fundamental factors – growth, inflation, and interest rates – that drive capital markets, and analyze the relationship to liabilities. Thus, if interest rates rise due to inflation, we utilize the same rise in inflation and interest rates in order to calculate returns on bonds and to determine if the discount rate is reasonable.

We use deterministic modeling of various economic scenarios in order to help comprehend the effects of specific economic events. We employ a set of six basic scenarios – base case, recession, stagflation, inflationary growth, ideal growth, and market correction – to illustrate and highlight the implications for different asset allocations. For example, the worst case scenario for the typical US pension plan is recession, as the present value of liabilities soars as interest rates decline while equities perform poorly. A relatively “good” scenario for a US pension plan is inflationary growth.

Stochastic modeling is used to help assign probabilities to the various market environments.

### Review Process

We recommend a formal review of asset allocation policies every one to three years, unless there are significant changes to the underlying benefit or demographic structure. Typically, we recommend an asset liability study every three to five years, although many of our larger clients review their asset allocations annually.

Once a year, we review and analyze the investment policy, asset allocation, and portfolio structure. This analysis would update the asset allocation with the most recent economic and financial data.

## References

Client Name	Contact Details
City of Pittsburgh Comprehensive Municipal Trust Fund	<b>Anthony J. Pokora</b> <b>Assistant Director</b> <b>City of Pittsburgh</b> <b>414 Grant Street</b> <b>Pittsburgh, PA 15219</b> <b>(412) 255-2899</b> <b><u><a href="mailto:tony.pokora@city.pittsburgh.pa.us">tony.pokora@city.pittsburgh.pa.us</a></u></b>
Smith & Nephew, Inc.	<b>Liz Sohn</b> <b>VP, US Compensation &amp; Benefits</b> <b>Smith &amp; Nephew</b> <b>150 Minuteman Road</b> <b>Andover, MA 01810</b> <b>(978) 749-1301</b> <b><u><a href="mailto:elizabeth.sohn@smithnephew.com">elizabeth.sohn@smithnephew.com</a></u></b>

**5. Do you provide educational services? If yes, describe the services you provide and how you provide those services.**

Mercer offers clients education through a variety of media and settings. On a larger scale, we host periodic client conferences and web seminars, addressing current topics of interest. On a smaller scale, we can provide education sessions that are individually tailored to meet a clients specific needs.

Mercer holds periodic client conferences around the world. These events are held in major cities such as Dublin, Montréal, London and Sydney. Conference attendees include clients, Mercer personnel and investment managers. Generally, Mercer's does not charge clients for attendance at our conferences but will charge investment managers that wish to attend. The goal of these events is to share intellectual capital with clients on a variety of subjects, offering educational sessions and opportunities to meet Mercer's thought leaders.

Most recently, Mercer's investment consulting business held the Americas Investment Forum in Montréal, October 2-3, 2008. This conference focused on investing in *The Brave New World*. Attendees heard how institutional investors might adapt to the changing marketplace. Senior Mercer investment consultants and guest speakers discussed asset allocation strategies, emerging market challenges and new opportunities in alternatives.

In addition to client conferences we also host roundtables at local offices and web briefings for clients on topics of interest.

Our role as investment consultants is to provide our clients with training regarding the investment program they desire or in any other area we believe it is needed. Over the last year we have provided training sessions to clients on the following topics:

- Distressed debt
- GTAA
- Hedge funds
- Currency overlay
- Asset liability matching
- Derivatives
- Board governance
- Transition management
- Securities lending
- Opportunistic investments:  
leveraged loans
- Private equity
- Infrastructure
- Portable alpha
- 130/30 (active extension)
- Emerging markets
- Investment industry trends
- Transparent hedge fund investing
- Custody
- Currency

**6. Describe your approach to allocating assets among investment styles.**

We help clients to determine an appropriate investment approach by helping to educate them as to the risks and rewards associated with various structures in order to determine their relative attractiveness. As a general rule, portfolios should be well-diversified, be reasonably liquid, and operate at the lowest cost possible based upon their individual investment criteria. We therefore attempt to implement various investment approaches that provide adequate liquidity to the fund.

Different styles include:

- Active vs. passive investment management
- Generalist vs. specialist managers
- Equity investment style: value vs. core vs. growth
- Market capitalization: large vs. mid vs. small vs. micro
- Top-down investment processes vs. bottom-up
- Duration: market neutral vs. tactical interest rate bets
- Concentrated portfolios vs. well-diversified portfolios
- Maturity: long vs. short
- Quality: high quality vs. high yield

In assessing the relative merits of one approach over another, we use a variety of tools to highlight the risk/return trade-offs of each approach. Our objective is to create "optimal" manager structures within each asset class. We consider optimal structures to be a function of diversification, return enhancement, risk control, and expense containment.

The anticipated size of the investment product being designed is embedded in our decision-making process, and, more specifically, the size of the allocation to a particular asset class is, as well.

We focus on identifying performance trends in the capital markets from different styles, the associated risks, and the direction in which investment management organizations are becoming more style dependent.

- 7. What investment styles are tracked in your performance measurement system? Our current allocation is 50% bonds, 50% equity. Are there other classes of investments which should be strongly considered?**

We believe alternative investments such as hedge funds including other areas of active management (structured products such as currency overlays), private equity funds and real estate, may be appropriate investments for the Port Authority. For greater details on the appropriateness of alternative investment for the Port Authority please see the response to question 9.

We use proprietary and non-proprietary universe and peer group comparisons for a wide variety of plan types and asset classes.

For total plan comparisons, we participate in and use the Mellon Analytical Solutions Trust Universes to compare our clients' total plan and total asset class performance with other fund sponsors of similar sizes and types. Following is a list of the Mellon Analytical Solutions Trust universes currently available.

Mellon Analytical Solutions Trust Universes	
Universe	Description
<b>Master Trust Funds</b>	Includes all corporate, foundation/endowment, public, Taft-Hartley and Healthcare plans.
<b>Master Trust Funds - Billion \$</b>	Includes all assets of corporate, foundation/endowment, public and Taft-Hartley plans with at least \$1B in assets.
<b>Total Funds - Corporate</b>	Includes all assets of corporate defined benefit plans.
<b>Total Billion \$ Funds - Corporate</b>	Includes all assets of corporate defined benefit plans with at least \$1 billion in assets.
<b>Total Funds \$250M To \$1B</b>	Includes all assets of corporate defined benefit plans with \$250M to \$1B in assets.
<b>Total Funds \$20M To \$250M</b>	Includes all assets of corporate defined benefit plans with \$20M to \$250M in assets.
<b>Total Funds - Foundations &amp; Endowments</b>	Includes all assets of foundation and endowment plans.
<b>Total Billion \$ Funds - Foundations &amp; Endowments</b>	Includes all assets of foundation and endowment plans with at least \$1 billion in assets.
<b>Total Funds &lt; \$ Billion – Foundations &amp; Endowments</b>	Includes all assets of foundation and endowment plans with less than \$1 Billion in assets
<b>Total Funds – Foundations</b>	Includes all assets of foundation plans
<b>Total Funds – Endowments</b>	Includes all assets of endowment plans
<b>Total Funds - Public</b>	Includes all assets of public funds

<b>Total Billion \$ Funds - Public</b>	Includes all assets of public funds with at least \$1 billion in assets
<b>Total Funds – Taft-Hartley</b>	Includes all assets of Taft-Hartley plans
<b>Total Funds – Healthcare Operating Funds</b>	Includes all assets of healthcare organization operating funds

At an asset class/manager style level, we have developed a wide array of proprietary universes to compare performance results. Universes have been created for both institutional and mutual fund products using manager provided returns. In order to assess the styles of particular managers/products, we employ a quantitative and qualitative assessment of each product in our universes.

Universe	Products	Universe	Products
US Equity Large Cap Core	426	Emerging Markets Equity	138
US Equity Large Cap Value	388	Europe inc UK Equity	154
US Equity Large Cap Growth	357	Europe inc UK Equity Small Cap	38
US Equity Large Cap Index	92	Asia ex Japan Equity	57
US Equity Large Cap Equity	1171	Pacific inc Japan Equity	30
US Equity Value	768	Pacific ex Japan Equity	60
US Equity Growth	751	International Equity Small Cap	43
US Equity Mid Cap Core	69	International Equity	313
US Equity Mid Cap Value	109	International Equity Passive	12
US Equity Mid Cap Growth	128	Global Equity	329
US Equity Mid Cap Index	18	International Fixed Unhedged	26
US Equity Mid Cap	306	International Fixed Hedged	4
US Equity SMID Core	46	Global Fixed Unhedged	78
US Equity SMID Value	67	Global Fixed Hedged	22
US Equity SMID Growth	79	Emerging Market Debt	62
US Equity SMID	192	US Real Estate Open End	28
US Equity Small Cap Core	137	US Real Estate Other	14
US Equity Small Cap Value	204	US Real Estate Public REITS	56
US Equity Small Cap Growth	187	US Short Term Inv Funds	41
US Equity Small Cap Index	23	US Balanced	85
US Equity Small Cap Micro	43	US Balanced Tactical Allocation	10
US Equity Small Cap	528	Global TAA - Excess Returns	27
US Equity Small+Mid Core	206	Currency Overlay - Excess Returns	49

US Equity Small+Mid Value	313	Currency Funds - USD Based	58
US Equity Small+Mid Growth	315	US Convertible Composites	19
US Equity Small+Mid	834	US Equity Combined	2197
US Fixed 1-3 Years	116		
US Fixed Core	293		
US Fixed Core Investment Grade	202		
US Fixed Core Opportunistic	91		
US Fixed High Yield	102		
US Fixed Intermediate	137		
US Fixed Long Duration	40		
US Fixed Mortgage Backed	35		
US Fixed Combined	723		

**8. Within the broad classes of bonds or equity, should there be targeted allocations to subgroups? If so, please elaborate.**

To meet your risk-adjusted return objectives most efficiently, we evaluate your alternatives in implementing the strategic asset mix you have chosen. We measure this efficiency by seeking the highest information ratio for the total portfolio, measured as the expected risk adjusted excess return *net of fees* divided by the tracking error.

In this phase, Mercer evaluates the following choices:

- Active vs. passive management in both equity and fixed income
- Large, mid and small cap equity allocations
- Growth / value /core style diversification throughout the capitalization range
- Emerging markets and unhedged currency exposures, for international equity
- For fixed income, exposure to international or non-investment grade bonds
- Real estate, private equity and hedge funds, either as alpha generators or as sources of risk management and diversification

Once we have identified portfolio structure alternatives we evaluate the Plan's current portfolio structure by performing holding-based style analysis on the equity and fixed income managers. We do not believe it is sufficient to categorize a manager based solely on its strategy (for example, a large cap growth manager will typically hold some stocks that do not meet the definition of large cap or growth). Holdings-based style analysis provides an accurate picture of the Plan's portfolio relative to the structure alternatives under consideration.

After the structure decision is made, we use the holding-based analysis to determine asset allocation changes that need to be made to implement the desired structure. This can include shifting assets between managers, adding additional managers, and/or removing managers.

To perform the holdings-based analysis we need to obtain portfolio holdings in electronic format for each of the current managers.

As a final step Mercer documents the target portfolio asset allocation and associated rebalancing ranges in an Investment Policy Statement.

**9. Please describe your view as to the appropriateness of "alternative investments" in a fund of our size.**

Mercer believes that a necessary first step in considering alternative investments is to develop a rationale system for classifying each according to portfolio benefits. We present such a classification system in the following table. It also must be noted that certain assets have multiple beneficial characteristics. For example, real estate is a long-life asset with meaningful cash flows and thus represents an indirect liability hedge. But it also has shown good sensitivity to inflation, as have other assets.

Equity-like returns	Liability hedging indirect/direct	Inflation-sensitive assets	Diversifiers (low equity correlation)
Private equity	Core real estate	Real estate	Market neutral hedge funds, currency
Commodities	Mature infrastructure	Commodities	Real estate
Growth infrastructure	Timberland	Infrastructure	Infrastructure
Opportunistic real estate	Farmland	Timberland	Commodities
Directional hedge funds	Global ILB, emerging market debt	Farmland	Timberland, Farmland

A key feature of our alternatives classification approach is the grouping of real estate, infrastructure, timberland and farmland under the heading of "hybrid" assets, due to their similar characteristics (long-life assets, with meaningful cash flows, inflation hedging that indirectly hedge pension liabilities).

Within each alternative asset class we can generally identify low, medium and high risk sub-strategies. A low risk sub-strategy in an otherwise high risk asset class may be less risky than a high risk sub-strategy in a lower risk asset class. For example, private equity debt financing (mezzanine) may be less risky than opportunistic (distressed) real estate, even though private equity overall would be considered more risky than real estate.

Risk Spectrum			
Asset Class	Low	Moderate	Higher
Private equity	Mezzanine	Buyout	Venture capital
Hedge fund of funds	Relative value/ Market neutral	Multi-strategy	Directional/ Opportunistic
Real estate	Core	Core-plus	Opportunistic
Infrastructure	Mature	Growth	Development/ Greenfield
Timberland	Global, species diversified	National, species diversified	Regional, species concentrated

It is important to note that where the assets are sourced from, to fund an allocation to alternative investments (i.e., stocks or bonds), is as important as which alternatives are included. This is largely because of the highly different return and volatility characteristics of stocks and bonds.

**10. Describe your recommended policies regarding bonds whose rating have been downgraded, when and under what circumstances such bonds should be sold.**

The general policy on downgrades would be defined in the Investment Policy Statements governing each client account. In general, we don't agree that downgraded bonds should be sold immediately, as this is the point in time of greatest selling pressure. Rather, client's should have guidelines prohibiting below investment grade rated bonds or setting limits on such exposure should be enforced by allowing managers a certain window to comply, such as 30, 60, or 90 days following the downgrade. As such, this is still a matter of client preference and can vary widely. For our view on downgraded securitized debt please see the attached paper "Relaxed Holdings Guidelines for Downgraded Securities".

**11. Describe how you verify compliance with investment styles.**

We review the total fund's overall compliance with the Investment Policy Statement on a quarterly basis. At both the total plan and manager level, we evaluate compliance with the client's statement of investment policy. We compare the plan's current asset allocation relative to policy targets and ranges. If any particular asset class is outside policy ranges, we work with our clients to develop a re-balancing strategy taking into account future contributions/withdrawals and transaction costs. We continually monitor investment manager's compliance with their investment guidelines. We are able through our systems, to aggregate individual manager portfolios in order to determine overall sector and stock exposure at the total plan level. This helps to ensure that managers are not taking inadvertent risks.

**12. Describe how benchmarks are developed and how performance is compared to relevant items. Describe what you consider relevant comparisons.**

We believe two different types of benchmarks should be used to fully evaluate investment manager performance: market-based and peer group-based.

**1. Market-based benchmarks** provide an absolute performance standard for manager performance. In exchange for paying active management fees and accepting active risk, sponsors expect the manager to provide excess performance (alpha) versus the appropriate absolute benchmark. It is certainly reasonable to expect managers to add value, net of fees, versus any market-based benchmark.

We utilize one of the following three benchmark types:

- **Appropriate Market Index** – Used when a mandate's investment guidelines substantially overlap the market index. The overlap can include security and issuer type, quality, and maturity/duration. This is related to a key benchmark criterion, investability, in that it should be possible to develop a passive vehicle that closely tracks benchmark performance.
- **Blend of Market Indices** – Used when a mandate spans multiple indices and a weighted multiple index performance average is appropriate.
- **Premium Over an Index** – Used when opportunistic investments in out-of-benchmark securities are permitted in the mandate. The expected premium relates to the proportion and alpha potential of permitted out-of-benchmark securities.

**2. Peer group benchmarks** provide a mandate's performance versus a universe of other managers managing similar mandates. This relative performance comparison, as opposed to the absolute performance comparison versus an index, measures a manager's skills against those of other potential managers.

We believe it is inappropriate to use performance comparisons without consideration of risk being accepted in pursuit of the return. We believe the best measure of risk is tracking error against the benchmark return, and particularly focus on information ratio – alpha divided by tracking error. In fact, our manager rating system explicitly evaluates the probability of a manager's generating an attractive information ratio.

**13. What information systems do you use to produce your reports? How frequently are reports produced?**

To enhance our analytical capabilities, we have an agreement with InvestorForce (IF) to utilize their web-based system to produce performance monitoring reports.

Mercer would provide formal reporting each quarter (typically 35 to 45 days after quarter-end) and ad hoc reporting when a particular situation warrants immediate discussions between the client and Mercer. For example, ad hoc reporting might include a manager change or a need to rebalance the asset allocation given prevailing market conditions.

Upon receipt of the performance evaluation report, Mercer would meet with the Committee each quarter to review the report and recommendations. Collectively, the Committee and Mercer would decide on action plans if necessary.

**14. Do you solicit or accept fees for placing investment managers or for including investment managers in your universe for placement? If so, describe the circumstances and process.**

No.

- 15. Describe how you detect early problems with investment managers. Provide examples of the tools used and the recommendations given. Remove all names from the examples to protect confidentiality.**

We detect early problems with investment managers by tracking changes in a manager's organizational structure or personnel, as well as their strategy and performance. These changes are noted in GIMD and as a matter of course, communicated to relevant clients. GIMD is web-based, permitting managers to directly update their information and our consultants worldwide to access the information. Investment manager meeting notes and news items distributed electronically to consultants worldwide are forwarded to clients when appropriate. Our insights and opinions provide timely information to clients and supplement their own due diligence activities.

The changes at Manager X is an example of an organizational change that we researched further, developed recommendations and communicated with our clients.

**Organizational Change:** An Asset Management firm announced the "lift out" of 16 investment professionals from Manager X's worldwide fixed income. Of particular importance was \$46.9 billion invested in stable value. The lift out included five global partners who each had significant experience managing the Stable Value portfolio.

**Action:** Jeff Gabrione, Global Investment Leader for Alternatives; Phil Suess, senior consultant and DC segment leader; and Liana Magner, Senior Consultant, met with INVESCO. The purpose of the meeting was to discern Mercer's comfort with Manager X's stable value capabilities given the departure of 16 individuals.

**Recommendations:** As a result of this meeting, Mercer did not recommend immediate termination of the Manager X Stable Value relationships. This recommendation is based upon;

- Our belief that client money is not at risk
- Manager X's investment structure, which emphasizes diversification through a fund of funds structure mitigates the risk of personnel changes negatively impacting fund performance.
- Manager X has committed to expand the exposure to outside managers
- No other stable value managers currently provides the diversification of underlying fixed income managers on as cost effective basis as INVESCO.

**Ongoing Actions**

- Place Manager X "on watch" and closely monitor the situation

- 16. Describe how you deal with problems with investment managers.**

There are times when manager performance is below expectations relative to policy guidelines and appropriate action is necessary. Our investment manager recommendations may fall into one of the following three categories:

- 1. Retain** – We have confidence in the investment manager's ability to add future value. The manager's investment performance is satisfactory, and has no significant organizational or strategic issues.
- 2. Place on Watch** – The manager's investment performance is unsatisfactory and/or issues relating to the organization or strategy are of concern.

**3. Terminate** – We do not have confidence in the manager's ability to add future value over a benchmark. We may recommend terminating a manager if significant concerns exist as to the organization or strategy.

#### Placing a Manager on Watch/Terminate

We recommend placing an investment manager on "watch" or to terminate when:

- We lose confidence in the management of the strategy. This can be due to:
  - Changes in organizational structure or personnel** – A significant change in culture, usually resulting from a merger, acquisition or key staff departure, that is likely to distort incentives and promote turnover;
  - Changes in strategy** – If the manager departs from the strategy and/or style for which it was originally hired to implement, such as a switch from a quantitative process to a fundamental one;
  - Performance** – continued performance shortfalls versus a peer group of managers with a similar style and/or market index.
- The characteristics of the portfolio no longer satisfy the desired or expected elements of the mandate
- The current style is no longer deemed appropriate

Our clients may review the manager status at any time, but normally do so during quarterly performance review meetings. They review our recommendations to either place managers on watch or terminate relationships, and vote on such recommendations after deliberation. Managers are generally placed on watch status for a period of time prior to a decision to terminate the relationship. However, there may be circumstances under which a client may elect to terminate a manager without first placing them on watch.

**17. Do you facilitate the transfer of assets between investment managers? If yes, describe the process.**

As discussed in the response to the manager search process Mercer works with a variety of clients in this capacity – from clients who wish to handle the transition process internally to clients who prefer that we handle the logistics of transitioning from one manager to another. We can also assist client in the search and evaluation of a transition manager.

Mercer has performed more than 100 transition manager evaluations over the last three years, giving us the experience to extract the nuances from transition manager proposals using the process summarized here.

The Mercer Sentinel® Group is a global team of specialized investment consultants who focus solely on investment operations and implementation. Evaluation of transition managers is a core competency for this global team of more than 40 professionals. We have well developed processes and procedures for evaluating every aspect of transition manager candidates, including their:

- |                             |                         |
|-----------------------------|-------------------------|
| ▪ Organization & financials | ▪ Business structure    |
| ▪ Execution capabilities    | ▪ Experience & staffing |

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>▪ Project management skills (commitment to procedural controls)</li> <li>▪ Technology platform</li> <li>▪ Explicit fees</li> </ul> | <ul style="list-style-type: none"> <li>▪ Reporting capabilities, including their pre-trade analytics</li> <li>▪ Client service capabilities</li> <li>▪ Implicit costs</li> </ul> |
|---|--|

Our process focuses on identifying, analyzing, and controlling risks and costs. Mercer's extensive global experience with trading and transition operations, such as custody, payment systems and securities settlement infrastructure, enables us to assist clients in identifying and addressing potential issues and complications prior to a transition commencing. In addition, our expertise helps clients structure mandates and compare methodologies and providers to minimize cost and risk.

Our evaluation process starts by identifying and understanding client needs and the risks in the anticipated transition activity. We document clearly defined client needs and propose a short-list of candidates for further evaluation. Next we perform a detailed benchmarking of each candidate's capabilities and controls relative to the specific client needs using Mercer's *Global Transition Manager Database*, a proprietary compilation of more than 110 transition management factors derived from questionnaire responses, onsite due diligence visits, and Mercer client experiences. We then use analytical software and modeling tools to conduct a competitive price and risk discovery process, which enables investors to understand the sources of risk and cost in their anticipated mandate. Because we use security-specific information instead of assumptions to solicit pre-trade proposals, we can compare and contrast transition manager responses effectively and ***clients can understand the sources of cost and risk.***

Mercer Sentinel's transition consulting focuses on providing investors with a comprehensive comparative evaluation framework to assess transition managers' capabilities and controls, documenting good governance.

To summarize, the essential steps in our process are:

- Assess client needs and risks in expected transition mandate(s)
- Identify and select candidate managers using Mercer Sentinel's proprietary *Global Transition Manager Database*. Integrate the client needs and risks review with our detailed benchmarking of each candidate's capabilities and controls
- Perform a competitive cost discovery process using security specific details. Where warranted, conduct price negotiation on behalf of the client

To amplify a prior point: Mercer Sentinel begins with a needs and risks analysis because the pre-transition strategy and planning portion of the process is critical to optimizing the overall transition process. In our experience, this important step is often overlooked by investors.

We tailor our service offering to client needs. Mercer Sentinel's three most common projects are:

- One time transition manager searches (a single mandate specific search)
- Transition manager panel creation projects (establishing a ready bench of transition managers)

- Cost and risk discovery project (used to award a specific mandate among panel members or pre-selected list of candidates based upon optimal risk/cost combinations)

Additionally, Mercer Sentinel can perform various custom projects upon request, including review of legal contracts from an investment and operations perspective.

**18. Provide specific examples of how you have added value for your clients.**

Mercer is a client service oriented investment consulting firm. Below is an example of how we have added value for a client who was developing a new asset allocation and transition plan.

**Service:** Develop new asset allocation and transition plan for pension plan of major division to be spun off

**Business situation:** A financial services company spun off to shareholders a business unit accounting for approximately 20% of the Pension plan assets and liabilities. The management team for the spin-off required advice on asset allocation and investment governance for the pension plan of the new company. The Investment Committee for the parent company needed advice on managing the transition of assets. All of these actions needed to be scoped and approved for implementation within 60 days.

**Action:** In partnership with Mercer actuaries, we evaluated the composition of the new company's liabilities, the relative size of the plan compared to the pro forma balance sheet and the proportion of the liabilities related to retired and terminated/vested lives to recommend to the new committee an initial strategic asset allocation for the plan. We could confirm the appropriateness of a similar asset allocation approach, with a high degree of interest rate risk hedging through long duration fixed income to mitigate the risk to funded status in the new company pension plan. In a series of meetings with the investment managers and staff, Mercer developed a streamlined portfolio structure which could be implemented largely by contributions in kind from the existing managers either to new separately managed accounts or via contributions in kind to commingled trust vehicles.

**Value :** Mercer worked quickly with the current and new fiduciaries to provide timely guidance on structuring the separation of the plan assets from the parent master trust and implementing a somewhat streamlined portfolio structure. Familiarity with their managers' account minimums and commingled vehicles for the investment strategies enabled us to craft an approach that avoided the transaction costs and market impact of liquidating stock and bond to cash to fund the new plan, and then incurring another round of transaction costs and market impact on purchasing new positions in the target asset allocation. The estimated cost of that "round trip" implementation would have been in excess of 1% of assets or \$2.5 million.

**19. Provide a list of all new accounts for professional evaluation and consulting services to qualified plan sponsors in the last five (5) years. Structure the list by year. Show type of client, e.g., by industry, public sector/private for-profit/private not-for-profit type of plan, size of plan, and date your services were required.**

In order to maintain client confidentiality we can not disclose client plan information without their prior approval. The table below show the number of clients we have gained in the past five years.

	2004	2005	2006	2007	2008
Clients Gained	30	24	29	32	33

- 20.** Provide a list of all accounts lost in the last five (5) years. Structure the list by year. Show type of client, e.g., by industry, public sector/private for-profit/private-not for profit, type of plan, size of plan, date the client was lost, and the reason the client was lost.

It is Mercer's policy not to disclose specific non-public information regarding clients and the reasons for termination. In the course of our business, consulting relationships have been terminated for a variety of reasons, such as merger, acquisition, or divestiture situations; changes in client business strategy; changes in our business strategy; plan terminations; or upon completion of projects. In 2004 Mercer's investment consulting business experienced a higher than average turnover in clients as a result of the investigation of investment consultants by the SEC. While the investigation revealed no wrongdoing on Mercer's part several clients terminated their relationships with Mercer due to 'headline risk'. Since that time some of these clients have re-established their relationships with the Firm.

	2004	2005	2006	2007	2008
Clients Lost	38	26	8	20	19

While these numbers may appear significant in absolute terms, they should be considered in the context of approximately 300 retainer relationships.

## C. Your Team

- 1.** Provide the names and location(s) of the team members who will be responsible for this account.

The team working with the Port Authority will include experienced and senior lead consultants, supported by other consultants with specialist expertise in areas we anticipate will be of interest. We have used this type of team structure consistently with other clients for more than a decade, and have found it to be helpful in facilitating the delivery of value-added investment results and high quality service to these clients.

Eddie Guerra will be the lead consultant for the Port Authority and Guy Cooper will be the co-lead consultant and strategic adviser. These professionals will have responsibility for the quality of investment consulting services and will be the day-to-day, "in-front" consultants to the Port Authority staff and the Pension Committee. Eddie and Guy are both based out of Mercer's Dallas office and have consulting responsibilities for all Texas based clients. While they are not based in Houston, Eddie and Guy both travel there regularly on client related matters. When expertise is required on certain topics, such as manager search, capital market theory and strategic asset allocation, this core team will access the assistance of specialists within our firm. In addition, analysts will support our core team, developing recommendations and reports, providing day-to-day delivery of generalist investment consulting, and performance monitoring.

**2. Provide a resume or brief biography of each team member.**

**Eddie Guerra**

Eddie Guerra, III is a consultant in Mercer's Dallas office, with over ten-years of investment experience. Eddie provides investment analysis to a wide range of institutional clients, assists in the establishment of investment policy and selection of investment managers, and the development of asset allocation strategies.

Prior to joining Mercer, Eddie served as a senior investment consultant for a national investment consulting firm where he assisted public pension plans, corporate pension plans, foundations and endowments in managing trust assets. He has also served as Manager of Investments for a large telecommunications company where he was responsible for the development and implementation of investment policy for the company's \$40 billion pension plan.

Eddie holds a BA in economics from the University of Texas at Austin and an MA in applied economics from Southern Methodist University in Dallas, Texas. Eddie also serves as Adjunct Professor at Dallas Baptist University and is currently a Level II Chartered Financial Analyst candidate.

**Guy Cooper**

Guy M. Cooper is a principal in Mercer's Dallas, Texas office. He has worked as an investment consultant since the 1970's and has served both corporate and large public sector entities for their defined contribution and defined benefit needs.

Guy has assisted a wide range of institutional clients in the establishment of investment policy, selection of investment managers, and the development of asset allocation strategies. In addition, he has extensive experience in several specialty areas: high yield and convertible bonds, governance practices, real estate and private equity partnerships, and asset and liability management. Guy also brings the perspective of the Chief Investment Officer, having served in that capacity for three entities, including an insurance company.

Guy holds a BA degree with honors in economics from Yale University and an MBA in investment theory from Stanford Graduate School of Business. He served as research assistant to two Nobel Prize winners: William F. Sharpe and James Tobin.

3. Name the current clients of each team member. Identify the type of client, type of plan, size of plan and how long each team member has provided services to the client.

Eddie Guerra		Guy Cooper	
Client/Plan Type/Length of Time	Plan Size	Plan type	Assets
City Public Pension Plan (over 10 years)	>\$450M	State Public Pension Plan (approximately 2.5 years)	>\$16B
Corporate Defined Contribution Plan (over 1 year)	>\$400M	Corporate Defined Contribution Plan (over 1 year)	>\$400M
Corporate Defined Contribution Plan (over 3 years)	>\$100M	Hospital Pension Plan (approximately 3 years)	>\$200M
Corporate Defined Benefit/Pension Plan (<1 year)	>\$50M	Hospital Pension Plan (approximately 3 years)	>\$100M
Corporate Defined Benefit/ Pension Plan (over 3 years)	>\$100M	Corporate Defined Benefit/Pension Plan (over 3 years)	>\$100M
State Employees Pension Plan (< 1 year)	>\$1.5B	State Employees Pension Plan (<1 year)	>\$1.5B

4. Describe the qualifications of the team members.

Please see our response to question 1.

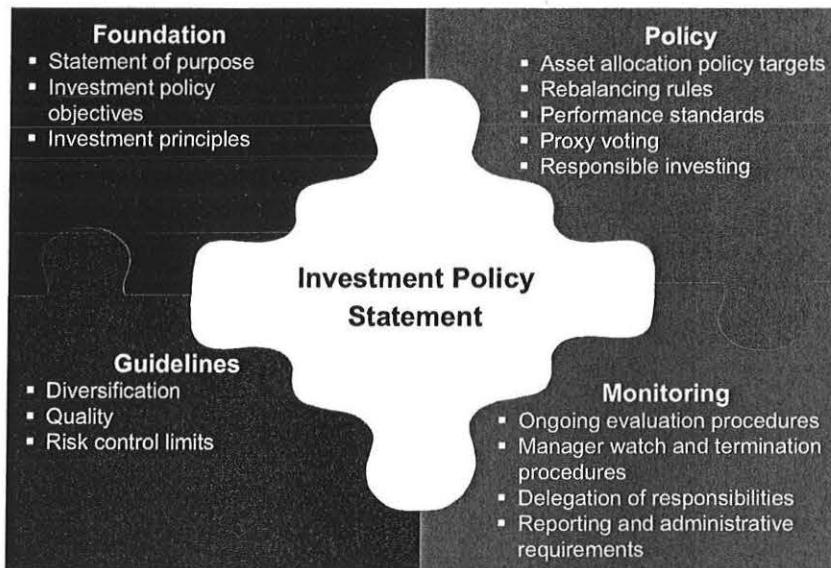
5. Will your company and each member of your team accept fiduciary responsibility for your services as a part of this contract?

As an SEC-registered investment advisor, Mercer is a fiduciary with respect to the investment advice we provide clients. ERISA and related Department of Labor regulations define certain investment advice as being ERISA fiduciary in nature. Mercer's acceptance of such ERISA fiduciary status, if applicable, would be solely with respect to our role as an investment advisor. Our responsibility would not include discretionary control of the Plans or their assets. We would have no responsibility for the actions or advice of investment advisors or service providers other than Mercer.

As an ERISA fiduciary with respect to the investment advice we provide to the Port Authority, we are responsible for providing that investment advice with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. We are also required discharge our duties with respect to our client's retirement plan for the exclusive benefit of the plan and its participants.

**6. Describe the team's experience with preparing reviewing and recommending changes to investment policies, guidelines and objectives.**

One of the key features of a strong plan governance structure is a well-developed investment policy statement that guides both fiduciaries and non-fiduciaries in the management of the plan. Eddie and Guy assist clients in enhancing and refining their investment policy statements to reflect plan objectives and risk tolerances that have been developed. This includes regular reviews and updates/enhancements, as appropriate. The graphic below depicts the key components of an investment policy statement.



The policy should reflect “*strategic*” or long-term objectives, rather than “*tactical*” objectives, or those that are short-term in scope. However, the policy must be dynamic enough to take advantage of and respond to economic, capital market, and program-related changes.

Following decisions made as a result of the asset allocation, portfolio structure and manager reviews (as required), we work with the client to review the investment policy statement. Such a document represents good governance by virtue of the fact that it (i) ensures continuity in the event of turnover of Board or staff members and (ii) it documents the decisions made and their underlying rationale - providing support in the event that the client is challenged by Plan participants or regulators, thus helping to manage reputational risk.

### The Process

**First** - evaluate the objectives and purpose of the Plan to make sure that we fully understand the directive.

**Second** - verify that the strategic policy has been outlined. We would expect this portion of the investment policy to list the asset allocation targets and ranges, the rebalancing rules and the investment manager performance standards.

**Third** - look for the investment manager guidelines to ensure proper diversification, appropriate quality restrictions and any prohibited transactions. In reviewing this portion

of an investment policy statement, we overlay the current policy with our understanding of the current investment manager lineup to make sure that we believe current guidelines are fair and that it maximizes the potential performance of each strategy.

**Fourth** - look for the investment policy statement to provide ongoing monitoring procedures. These procedures typically include timing of ongoing evaluations, delegation of responsibilities to various parties, reporting requirements, proxy voting procedures and general decision rules on what is and is not acceptable performance to the Fund. We have found that by having a very detailed investment policy statement, communication with the investment managers is improved and fewer misunderstandings occur.

As we review a current investment policy, we prefer to redline the document with our suggested changes and then have a detailed meeting with the client regarding our proposed changes. After talking through the issues, we typically agree which items are enhancements and which items are not necessary. Once the revised investment policy statement is agreed to, we share the document with each investment manager for their written comments. We then discuss any pertinent issues with the client to get agreement. Once finalized, we ask all managers to provide a signed statement that they have received and reviewed the investment policy statement and that they agree to adhere to the policy. Through our performance monitoring work, we will verify manager compliance on an ongoing basis.

Mercer's competitive advantage in this area rests within the nearly four decades of providing investment consulting services not only to defined benefit plan sponsors, but to defined contribution plan sponsors, foundations and endowment funds, hospital operating funds as well as corporate and public entity Treasury areas.

Our vast global experience in this area combined with the depth of our staff has helped thousands of clients ensure a comprehensive, client specific document.

**7. Describe how you will monitor compliance with the investment policies, guidelines and objectives.**

We review the total fund's overall compliance with the Investment Policy Statement on a quarterly basis. At both the total plan and manager level, we evaluate compliance with the client's statement of investment policy. We compare the plan's current asset allocation relative to policy targets and ranges. If any particular asset class is outside policy ranges, we work with our clients to develop a re-balancing strategy taking into account future contributions/withdrawals and transaction costs. We continually monitor investment manager's compliance with their investment guidelines. We are able through our systems, to aggregate individual manager portfolios in order to determine overall sector and stock exposure at the total plan level. This helps to ensure that managers are not taking inadvertent risks.

**8. Do you envision managing a portion of the assets?**

No.

**9. How do you propose that the Pension Committee measure and evaluate your performance?**

When hired for an engagement, Mercer works with you to establish performance criteria based on your individual objectives and requirements. We value a relationship with you and seek to exceed your expectations in delivering value on these engagements. When appointed, we will work with the Port Authority to agree on performance criteria for the work assigned.

Client satisfaction and feedback are integral pieces to help us measure our performance. We seek client input on both qualitative and quantitative matters to measure our level of services. In the course of our regular work, we formally and informally solicit feedback on such issues as:

- Accessibility and responsiveness of consultants to your staff
- Appropriateness of advice, given your specific objectives and risk tolerance
- Clarity of communications
- Responsiveness and professionalism of our support staff
- Accuracy of information provided
- Project management, including:
  - Timeliness of expected deliverables
  - Turnaround time on requests
  - Communication about project status
  - Nature of service problems experienced
  - Speed of problem resolution
  - No surprises

Client Experience Measurement (CEM) is Mercer's consistent global approach for gathering client feedback through formal face-to-face reviews with key buyers. We use the quantitative and qualitative feedback to produce actionable feedback for client teams as well as client satisfaction metrics that can be compared around the world.

We proactively inform all Mercer offices of both positive and negative client feedback. We also use this information to evaluate the performance of Mercer professionals.

**10. Describe what materials will be provided for performance evaluation and how that material will be prepared. Describe the quality controls in place to ensure the integrity of the information provided. Please include samples of your performance measurement reports.**

The goal of our performance evaluation process is to help clients meet their fiduciary responsibility by evaluating:

- Fund's adherence to policy guidelines
- Current investment strategy of the fund and its underlying managers
- Future capital market expectations and market trends

We believe that the management of a fund is a continuous process and is not limited to providing a quarterly performance report. Our ongoing performance evaluation includes, but is not limited to:

- Periodic performance evaluation reports. These comprehensive reports provide information on asset allocation relative to policy targets; investment performance relative to appropriate index benchmarks and peer groups for the total fund and each manager; period-end portfolio characteristics; and investment policy compliance. Additionally, our reports include customized commentary at the total fund and manager level. We typically provide reports on a quarterly basis.
- Ongoing due diligence on the fund's investment managers. We provide continuous due diligence on changes that may significantly impact a client's investment managers. If concerns arise relating to these managers, we issue recommendations for appropriate action as needed.
- Ongoing investment consulting services. As significant changes occur in the capital market environment or available investment alternatives, we provide clients with educational presentations, information and recommendations to assist them in meeting their fund's long-term objectives.

To enhance our analytical capabilities, we have an agreement with InvestorForce (IF) to utilize their web-based system to produce performance monitoring reports.

For monthly performance calculation purposes, IF employs the Modified Dietz performance calculation methodology. This methodology utilizes beginning and ending market values and intra-month cash flows to calculate a rate of return for a specific month-end / period-end at both the account and composite levels. Additionally, for accounts where there has been a large cash flow (defined as greater than 10% of the portfolio value), Mercer has the option of calculating the time-weighted rate of return using the exact date of the cash flow. All underlying performance calculation methods are compliant with CFA Institute Performance Presentation Standards.

Mercer utilizes a centralized group, the Performance Analysis and Reporting Division (PARD), to reconcile monthly manager-reported returns with custodial generated returns. Performance information is received by PARD directly from fund managers who then follow a detailed process to reconcile any return discrepancies within mutually acceptable asset-class specific tolerance bands. This process consists of identifying the appropriate amount and timing of cash flows, the investigation of reasons for market value discrepancies between the custodian and investment manager (i.e. pricing variations or trade vs. settlement date accounting) and finally, a careful check of calculation methodology and verification of the treatment of accrued income and dividends.

Mercer is able to solve most reconciliation issues through this process. If additional problems exist, PARD analysts act as liaisons between the custodian and investment manager until a resolution is reached.

In collecting manager based returns, Mercer requests managers to present composites in compliance with CFA® Institute Performance Presentation Standards. Managers are asked to confirm whether they are Level I and Level II compliant, and if so to provide their auditor's name. We do not independently verify every composite return stream, as this would be impractical with more than 20,000 strategies in the database. We do, however, regularly check dispersion among actual client accounts and manager composites for frequently used investment strategies, and compare reported composite information to actual performance achieved for our clients.

Following the reconciliation, three sets of universe data (Mercer Manager Universe Data, MAS Trust Universe Data and Index Universe Data) are considered toward the generation of extended time period returns for all managers and composites which are sent to the field for a mandatory peer review process. Following this, a quarter-end book is put together and sent off to Mercer's field offices.

### **Reporting**

When structuring a performance evaluation report, our consulting team works with our client to identify and detail specialized areas of focus appropriate to each client's portfolio structure and areas of interest. Reports integrate commentary, tables and color graphics that help to convey this information. There are numerous options for clients within the following areas:

- Asset allocation
- Performance reporting – total fund, equity/fixed income segments, individual managers
- Risk analysis
- Portfolio characteristics (domestic and international equity, fixed income)
- Performance attribution
- Style analysis

Mercer would provide formal reporting each quarter (typically 35 to 45 days after quarter-end) and ad hoc reporting when a particular situation warrants immediate discussions between the client and Mercer. For example, ad hoc reporting might include a manager change or a need to rebalance the asset allocation given prevailing market conditions.

### **Formal Reporting**

- Overview of the economic and capital market environment as well as market trends
- Highlights of any organizational issues, within an investment management firm, meriting attention
- Qualitative evaluation of current asset allocation strategy, manager structure and individual investment strategies utilized
- Detailed attribution and quantitative graphs showing absolute results, relative results and other attribution analysis
- Compliance review versus investment policy standards

### **Ad Hoc Reporting**

- Manager meeting notes and news memos
- Relevant research and white papers
- Capital market assumptions and economic news alerts
- Mercer Surveys

Upon receipt of the performance evaluation report, Mercer would meet with the Committee each quarter to review the report and recommendations. Collectively, the Committee and Mercer would decide on action plans if necessary.

Please see the appendix for the sample performance evaluation report.

### Quality Control

Mercer ensures the quality and accuracy of our consulting advice and services through a variety of methods:

- We maintain and all of our field consultants leverage centralized resources such as our Manager Research Group who will only assign one rating to each strategy for use by our consultants globally, our Mercer Sentinel® Group which researches custody capabilities and leads the delivery of custody selection and consulting assignments globally, and our Strategic Research Committee which leads non-manager/non-custody research and generates "house views" on important investment issues for application globally.
- Each of our consultants, regardless of their location, accesses the same set of information about investment managers and Mercer's research and ratings of these managers via our web-based Global Investment Manager Database (GIMD®); ([www.MercerGIMD.com](http://www.MercerGIMD.com)).
- We use a well-developed Intranet for effective and efficient communication of information and intellectual capital across offices.
- We use a formal system of professional standards to help ensure the quality and accuracy of our consulting advice and services. All work Mercer performs is peer reviewed by a second senior consultant to help ensure its accuracy, appropriateness and consistency with our house views.

**11. How do you propose that the Pension Committee measure and evaluate the performance of the investment managers?**

We would suggest evaluating fund and investment manager performance within a formal in-person quarterly meeting. We typically present the results of our quarterly monitoring process in addition to discussing current and future capital market trends.

Additionally, we monitor a client's investment managers on a daily basis and notify clients via e-mail of any significant changes. If conditions warrant changes to the fund, we will set up a conference call to discuss next steps.

**12. Describe the materials to be used for performance evaluation of investment managers and how that material will be prepared. Describe any quality controls in place to ensure the integrity of the information provided.**

Please see the response to question 10.

**13. Please provide a report showing the combined results of your clients' investments for the previous one, three, five and ten years. For clients that you have provided services for only a portion of the time periods requested, state the time period for which you have provided services.**

The performance analysis presented below shows the actual performance achieved by Mercer's US DB retainer clients at a total Plan level measured against their total Plan composite benchmark indices. This data is not intended to represent investment performance achieved by Mercer for any of its clients. Rather, Mercer has compiled this

analysis to demonstrate the performance of a sub-section of institutional investors who have had access to qualitative, forward-looking research on investment managers.

The performance analysis below includes performance data received from all Mercer's US DB retainer clients that meet the following criteria: (i) have a retainer relationship with Mercer throughout the entire period presented; and (ii) have provided to Mercer both plan composite and benchmark performance data for the entire period presented. Retainer relationships include all arrangements where Mercer has been engaged to perform manager monitoring on an ongoing basis, as evidenced by provision of regular formal performance monitoring and evaluation reports.

<b>For one year ended June 30, 2009</b>				
<b>Plan Type</b>	<b># of Plans</b>	<b>Actual</b>	<b>Index</b>	<b>Outperformance</b>
Corporate DB Plan Clients	96	-13.51	-13.53	0.03
Public DB Plan Clients	23	-16.97	-16.49	-0.48
Other Non-DC Clients	35	-15.14	-15.34	0.20
Total Clients	154	-15.16	-15.27	0.11
<b>For three years ended June 30, 2009</b>				
<b>Plan Type</b>	<b># of Plans</b>	<b>Actual</b>	<b>Index</b>	<b>Outperformance</b>
Corporate DB Plan Clients	80	-1.73	-1.73	0.00
Public DB Plan Clients	18	-2.72	-2.71	-0.01
Other Non-DC Clients	31	-2.10	-2.21	0.11
Total Clients	129	-2.13	-2.21	0.08
<b>For five years ended June 30, 2009</b>				
<b>Plan Type</b>	<b># of Plans</b>	<b>Actual</b>	<b>Index</b>	<b>Outperformance</b>
Corporate DB Plan Clients	72	1.92	1.72	0.19
Public DB Plan Clients	18	1.90	1.47	0.43
Other Non-DC Clients	31	2.36	1.76	0.60
Total Clients	121	2.23	1.72	0.53
<b>For ten years ended June 30, 2009</b>				
<b>Plan Type</b>	<b># of Plans</b>	<b>Actual</b>	<b>Index</b>	<b>Outperformance</b>
Corporate DB Plan Clients	52	2.63	2.05	0.57
Public DB Plan Clients	16	3.20	2.32	0.89
Other Non-DC Clients	23	2.99	2.16	0.82
Total Clients	91	2.97	2.17	0.80

The figures presented above represent equal-weighted averages of the types of clients shown. The 1, 3, 5 and 10 Year Fund Average is a simple average of every plan's annualized composite performance. The 1, 3, 5, and 10 Year Index Average is a simple average of every plan's annualized plan specific benchmark performance. The 1, 3, 5, and 10 Year Outperformance Average is a simple average of every plan's annualized excess return. The excess return for each individual client is calculated based on the performance of each client's total fund, less the performance of the composite benchmark index for their total fund. It should be noted that Mercer's clients on average make substantial use of passive and enhanced index investment strategies, especially in asset classes Mercer believes to be relatively more efficient, such as US large

capitalization equities. Mercer did not attempt in this analysis to back out the resulting passive return components to isolate the active contribution.

The underlying return figures are generally gross return series, except in cases in which the underlying vehicles include commingled funds from which fees are deducted before performance is calculated, or other cases in which the return series calculated for the client is net of fees. The performance analyzed includes only those managers actually utilized by Mercer clients, for the periods for which they were utilized, and includes the impact of transaction costs and market impact involved in transitioning between terminated and newly hired managers.

The performance achieved by these clients reflects decisions taken by their fiduciaries. Mercer did not exercise discretion for any of these clients, and the results they achieved were impacted by many factors besides Mercer's advice. Past performance does not guarantee future performance.

The performance data included in this analysis has been obtained from Mercer clients and their representatives and has not been independently verified or reviewed by Mercer. Mercer makes no representations or warranties as to the accuracy of such information, and accepts no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in such information.

**14. Do you accept compensation, either directly or indirectly, from the investment managers you recommend?**

No.

**15. Have you, any of your affiliates, or any of the team members:**

- **Undergone bankruptcy?**

No.

- **Undergone liquidation?**

No.

- **Undergone a proceeding similar to bankruptcy or liquidation?**

No.

- **Had a license revoked?**

No.

- **Had their investment or consulting activities restricted?**

No.

- **Been sued by a client?**

Yes.

- **Been found liable or guilty in an administrative, civil, or criminal matter or proceeding by any federal, state or local authority (other than misdemeanor, non-moving traffic violations)?**

In the ordinary course of business, Mercer is involved with litigation and other legal proceedings, investigations, and inquiries, some of which are conducted on an industry-wide basis. The outcomes of currently pending litigation, investigations, and inquiries are not expected to have any material adverse effect upon Mercer or its ability to service its clients.

- **Been sued or investigated by the Securities & Exchange Commission, the Department of Labor, the Texas Pension Review Board, or any other federal, state or local authority?**

Yes.

- **Been denied liability insurance or a fidelity bond?**

No.

- **Please elaborate on any yes answers to the above questions.**

In the ordinary course of business, Mercer is involved with legal and regulatory proceedings, investigations, and inquiries, some of which are conducted on an industry-wide basis. Currently regulators are reviewing various business practices across our industry, including compensation of and disclosure by providers of insurance placement services to ERISA employee benefit plans and by investment consultants to pension plan sponsors and others. The outcomes of currently pending litigation, investigations, and inquiries are not expected to have any material adverse effect upon Mercer or its ability to service its clients.

Beginning in 2004, the SEC examined the practices, compensation arrangements and disclosures of consultants that provide services to sponsors of pension plans or other market participants, including, among other things, practices with respect to advice regarding the selection of investment advisors to manage plan assets. On September 19, 2007, we received a letter from the SEC indicating that it had completed the investigation of Mercer and was not recommending any enforcement action.

In January 2006, Mercer received a subpoena from the US Department of Labor (DOL) requesting information related to our business. We promptly provided the DOL with an overview of our business model and activities, fully cooperating with their examination. On January 28, 2008 we received notice that the DOL had finished its review and concluded that no further action was contemplated.

#### **D. Your Fees**

- 1.** Provide sufficient detail to describe the fees you propose to charge. Please enclose the fee proposal in a separate envelope which is self addressed and stamped for our use to return your fee proposal should your proposal not be selected.

Per your request we have enclosed our fee proposal in a separately sealed envelope for your consideration.

- 2.** State the contractual period for which these fees are guaranteed.

Information provided in a separately sealed envelope.

- 3.** State any proposed escalation of fees.

Information provided in a separately sealed envelope.

**E. Our form contract is attached as Exhibit A. Please review it carefully.**

Please see below for our proposed list of exceptions to the form contract.

Port of Houston Authority  
Request for Proposals – Exceptions

1. Section 6: The insurance provided should be with respect to specific amounts, not minimum amounts. All insurance, other than Errors and Omissions insurance, will be placed with insurers having a Best's rating of A-VII or higher. The PHA shall be included as an additional insured under the Commercial General Liability with respect to the vicarious liability arising from Service Provider's performance of the services and only such policy shall be primary with respect to claims arising directly from Service Provider's performance of the services. Service Provider meets the bonding requirements of Section 412 of ERISA solely to the extent applicable. Service Provider carries Errors and Omissions coverage of \$10,000,000 per claim. Subsequent to the commencement date of the Agreement, Service Provider will provide insurance certificates at the request of the PHA. Service Provider's insurer will endeavor to provide at least 30 days advanced notice of any material modification or termination of the policies of insurance required under the Agreement.
2. Section 7: This section should be revised to provide that only completed materials that have been prepared specifically and exclusively for the PHA by Service Provider shall be owned by the PHA. Service Provider shall retain all of its rights in its own intellectual capital (such as methodologies, know how, models, tools and graphic or digitized representation of any of these) now possessed or subsequently developed by the Service Provider and the same shall not be considered Work Product owned by the PHA. The PHA should be responsible for, and Service Provider should not have any liability with respect to: (i) use of Work Product in a manner not mutually contemplated by the parties when the PHA first retained Service Provider, or (ii) any modifications made by the PHA to such Work Product.
3. Section 8: The PHA should be entitled to examine only those books and records directly related to the performance of the services under the Agreement. The audit right should not extend to payroll or personnel records. Any such audit conducted on Service Provider's premises should be subject to the execution of a mutually acceptable confidentiality agreement. Service Provider will retain records in accordance with its recordkeeping policies, and as for such length of time as is required under law. Service Provider should not be required to notify or consult with the PHA regarding its intent to delete Records.
4. Section 9: Service Provider's indemnification obligations shall only extend to damages actually incurred and then only to those damages proximately caused by or arising out of the grossly negligent acts or omissions or bad faith of Service Provider or its officers, directors, partners, employees, agents, independent contractors, subcontractors or other representatives in the performance of services under the Agreement. The Service Provider's indemnification shall also be with respect to reasonable attorney's fees incurred. The Service Provider's indemnification obligation shall not be applicable to the extent any loss, claim, suit, action, damage, liability or cost is attributable to the negligent

or wrongful acts or omissions of an Indemnitee. In no event shall Service Provider be liable in connection with the services or the Agreement for any losses resulting from: (i) acts or omissions by any investment manager, custodian or other third party, (ii) any inaccuracy or incompleteness of the data to be provided by the PHA or its representatives, or (iii) indirect, special, punitive, consequential or incidental damages. We would request the deletion of Section 9(c).

5. Section 10: We would request that Service Provider be permitted to subcontract to affiliated third parties without the prior written consent of the PHA.

6. Section 11: Service Provider should not be required to treat information as confidential if it is (i) required to be disclosed by law or legal process, or otherwise requested by a governmental regulator with jurisdiction over Service Provider; (ii) either already in the public domain or enters the public domain through no fault of Service Provider, (iii) available to Service Provider from a third party who, to Service Provider's knowledge, is not under any non-disclosure obligation to the PHA, or (iv) independently developed by or for Service Provider without reference to any confidential information of the PHA. We would also like to include language affirming that Service Provider may use any information and data supplied by the PHA to create analytical trend data (in anonymous form) to improve the quality of Service Provider's advice to all clients, including the PHA. In the event of a breach or threatened breach of Section 11, the PHA should be entitled to seek injunctive relief.

7. Section 13(a)(ii): Service Provider will be a "Fiduciary," as defined in Section 3(21)(A) of ERISA solely with respect to the investment advice it provides to the PHA to the extent that such advice is considered to be fiduciary in nature under ERISA and applicable Department of Labor regulations.

8. Section 13(a)(v); 13(a)(viii); 13(a)(x): We would request that these representations be made to Service Provider's knowledge.

9. Section 13(a)(xi): Service Provider will perform services under the Agreement in accordance with industry standards and the requirements of the Agreement.

10. Section 13(c): The availability of Service Provider employees as consultants in any litigation, hearing or proceeding will be on such terms as may be agreed by Service Provider and the PHA at such time.

11. Section 14: We believe that this section does not apply to the provision of consulting services, and as such should be deleted.

12. Section 19(d): We would request that any suit arising out of any agreement between the PHA and Service Provider be tried in a Federal or State court in the State of Texas. We would request the inclusion of language by which the PHA (i) waives its right to a trial by jury in any action or other legal proceeding arising out of the Agreement, and (ii) the PHA agrees not to include any employee or officer of Service Provider as a party in such legal proceeding.

F. Provide at least three references (with client name, address, telephone number and (contact person), from clients for whom you currently provide, and for the past three years have provided, pension consulting services.

Client Name	Contact Details
City of Pittsburgh Comprehensive Municipal Trust Fund	<b>Anthony J. Pokora</b> <b>Assistant Director</b> <b>City of Pittsburgh</b> <b>414 Grant Street</b> <b>Pittsburgh, PA 15219</b> <b>(412) 255-2899</b> <b><u>tony.pokora@city.pittsburgh.pa.us</u></b>
El Paso City Employees' Pension Fund	<b>Robert B. Ash</b> <b>Pension Administrator</b> <b>El Paso City Employees' Pension Fund</b> <b>2 Civic Center Plaza</b> <b>El Paso, Texas 79901-1196</b> <b>(915) 541-4545</b> <b><u>ashrx@elpasotexas.gov</u></b>
Sonoco Products Company	<b>Jay King</b> <b>Treasury Manager</b> <b>Sonoco Products Company</b> <b>1 North Second St.</b> <b>Hartsville, SC 29550</b> <b>(843) 383-6209</b> <b><u>jay.king@sonoco.com</u></b>

## G. Any other information you wish to provide.

In addition to the services and capabilities we described throughout the proposal, we would like to provide the Port Authority with additional information regarding our specialist resources. The range and complexity of issues facing institutional investors are much different than they were just five years ago. Plans are under increasing scrutiny by regulatory agencies, governmental bodies, the legal community, the press and participants. More than ever, clients similar to the Port Authority are asking Mercer very specific and complex questions that require a "subject matter expert".

We believe the Port Authority will benefit from the knowledge and advice each specialist group provides in areas such as:

**Strategic Asset Allocation** – Our Financial Strategy Group (FSG) helps clients meet their needs for integrated investment and actuarial advice to manage the financial risks of their pension plans. Funding reform, accounting transparency and the continuing sponsorship of frozen or closed DB plans puts an increased emphasis on balancing costs and risks for DB plan sponsors.

**Investment Operation Advice** – Our Mercer Sentinel® Group is a highly specialized research unit responsible for advice pertaining to investment operations and administration in order to help clients minimize risk and reduce costs. Services include trustee/custodian evaluations, securities lending, master trust design and implementation, fund accounting, foreign exchange services, fee benchmarking, trade cost analysis, commission recapture, and transition management.

**Responsible Investing** - Since 2004, Mercer has offered specialist resources to assist clients in the responsible investment (RI) arena. The RI team includes 14 dedicated professionals as well as a number of local champions, who work with clients who want to develop or implement investment programs that consider environmental, social and governance (ESG) issues. Located in offices around the globe, the RI team offers services ranging from manager search, selection and monitoring to policy development, stakeholder-specific solutions and education sessions.