Response to RFP Follow-up Questions:

1. Please provide any comments or concerns your firm may have with the current Investment Policy Statement and if so, what amendments/changes would you propose?

Russell has experience working with clients to create necessary documents that are aligned with the goals and objectives of its clients and are focused on providing guidance to fiduciaries when discharging their responsibilities. An Investment Policy Statement is an essential document in a well-designed governance structure. As an essential document, its development requires considerable interaction with the fiduciaries in order to create a custom document focused on their specific situation. While that is not possible to accomplish at this point, Russell will work with the fiduciaries to develop an appropriate policy statement for their needs.

However, we offer the following comments regarding the current FELRA Investment Policy Statement, while recognizing that more work will need to be performed to accurately capture their needs in a governing document.

A) Since the current Investment Policy Statement was drafted, it appears that the situation of the plan has changed from an on-going plan with an objective of providing sufficient funding to discharge promised retirement benefits to one that will have insufficient assets to do so. This change should be reflected in the policy documents.
B) According to actuarial projections, the investment horizon for investing actives has changed from long-term to a shorter-term. This should be reflected in the documents.
C) Given the funded position of the plan and the cash flow projections, liquidity is of higher importance to the prudent management of the assets. A statement addressing liquidity needs should be included in the documents.
D) Since the investment time horizon has shortened and liquidity needs have become more important, the investment allocation and investment vehicles chosen for use by the plan need to be aligned with the changed circumstances.
E) Given the need to continue to pursue return while recognizing the reduced investment time horizon and the negative impact of possible poor investment returns, volatility expectations of the asset structure need to be given careful consideration and expressed in the governing documents.

Russell would suggest that the fiduciaries consider working with an organization experienced in drafting suitable governing documents, and, given the significant change in funding status, create new documents rather than amend existing ones.

2. After reviewing the enclosed info, please set forth how you would propose to structure the portfolio for each Fund (legacy and new). This explanation should include:

A. Asset allocation (including asset classes and asset subclasses), portfolio structure (number of managers, use of active vs. passive strategies), types of accounts (separately managed, limited partnership vehicles, commingled funds, etc)

Legacy Standard	
Multi-Asset Core	50%
Managed Volatility	25%
Multi-Manager Bond	25%

Legacy Lower Volatility	
Multi-Asset Core	35%
Managed Volatility	20%
Multi-Asset Fund QTRLY	20%
Multi-Manager Bond	13%
Long Credit Bond	12%

New Fund	
Multi-Asset Core	75%
Multi-Manager Bond	10%
Long Credit Bond	10%
High Yield	5%

The funds vary in active/passive makeup but the minimum would be approximately 20% passive, depending on the final allocations. All funds in our recommendation are commingled and highly liquid. The number of managers could vary depending again on the final structure, but the minimum number of managers would be approximately 30.

B. Proposed fee, assuming that type of portfolio.

The Fee for the proposed portfolio Structure will be in the 56.3 bps range depending on final structure.

C. How you would envision transitioning the existing portfolio of the legacy Fund into the structure you propose and the associated costs and issues you anticipate.

Russell's Transition Management team provides fully transparent execution for its funds and outside clients. As the only pure agency broker-dealer provider in the industry, Russell will also act as a fiduciary over the assets in transition. In our opinion, liquidations of this magnitude should always use a professional Transition Manager, where the cost savings can be significant. Russell has received "Top Marks", for the eighth year in a row, in the transition management survey conducted by Global Investor magazine. Categories include: accuracy of pre trade estimate, operational efficiency, overall service, post-trade analysis, pre-trade analysis, project management, relationship management, reporting during transition, risk management, trading / execution, transparency of fees and costs.

The all-in cost of such a transition is approximately 24 bps on the liquid equity and fixed income asset classes. Should the client decide to provide Russell with cash and forego the recommended course of using a Transition manager, there would be zero commission to buy into the new portfolios under the Russell umbrella. If Russell is selected, we would strongly advise against managers handling the liquidations.

The other assets would need deeper examination in detail to assess the cost. In such cases where an illiquid asset would be prohibitively expensive to remove, we would work with the client to incorporate these assets into the allocation going forward.

3. Discuss how you would address both the negative cash flows from the legacy plan as well as the incoming cash flows for the new plan and describe how cash flows for both would impact the portfolio structure both at the outset of the relationship and over time.

From an asset allocation perspective the negative cash flows should be managed by having a fully liquid portfolio (so benefit can be paid from all asset classes) and having a low risk portfolio.

The fully liquid portfolio is important because the plan has a net outflow in the near future of about 90M, meaning that 90M in assets must be sold each year to pay benefits (the actual benefits are nearly 140, but about 50 is coming in from contributions). That 90M is about 15% of the current fund, and that percentage will increase each year as asset values decline (which will certainly be the case, and was the case provided in your projections). This would mean that assets without very short term liquidity should be eliminated from asset allocation considerations.

Negative outflows are especially dangerous for highly volatile asset allocations because there is very little recovery time, as they no longer have a long term time horizon. The 8% return projection has this plan going to $0 is 8 years (sometime during 2021) having one bad year (-20% return) could shorten that by 3 years (run out in 2018) even though you only lose less than a year's worth of benefit payments. Therefore a lower volatility approach should be a primary strategy, this could be achieved by using more fixed income or specific volatility managed strategies.

The legacy plan's time horizon is less than 8 years (and $ weighted, probably 4 years) which does not allow for a long term view of the markets.

The matter of the "successor plan" that will presumably start in 2013 would be to invest to achieve the actuarial required rate of return that when combined with plan contributions will fund the plan over the long term. Part of this goal should be a firm benefit policy, which is beyond the scope of the investment manager. This plan will start off quite small in asset size, but is projected to reach 100M by 2012 and 200M by 2022. This plan has very low liquidity requirement in the early years and but also lower asset values. The portfolio should start with very standard assets classes when it has low dollar amounts and can begin to expand into alternative and diversified allocations as size grows