SBA FLORIDA
STATE BOARD OF ADMINISTRATION

SBA TRUSTEES' MEETING

November 7, 2017

MEETING OF THE STATE BOARD OF ADMINISTRATION

GOVERNOR SCOTT AS CHAIR
CHIEF FINANCIAL OFFICER PATRONIS
ATTORNEY GENERAL BONDI

November 7, 2017

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AGENDA

ITEM 1. **REQUEST APPROVAL OF THE MINUTES OF THE October 17, 2017 CABINET MEETING.**

(See Attachment 1)

ACTION REQUIRED

ITEM 2. **REQUEST APPROVAL TO FILE A DIRECT ACTION AGAINST VALEANT PHARMACEUTICALS INTERNATIONAL, INC. IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY ALLEGING VIOLATIONS OF THE FEDERAL SECURITIES LAW AND OTHER ACTIONS.**

(See Attachment 2)

ACTION REQUIRED

ITEM 3. **EVALUATION AND REAFFIRMATION OF THE EXECUTIVE DIRECTOR**

F.S. 215.441 provides that the State Board of Administration's Executive Director must be reaffirmed annually by the Board of Trustees following the original appointment. Mr. Williams was appointed Executive Director in 2008.

(See Attachment 3)

ACTION REQUIRED

STATE BOARD OF ADMINISTRATION
OF FLORIDA

1801 HERMITAGE BOULEVARD, SUITE 100
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

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32317-3300

RICK SCOTT
GOVERNOR
CHAIR

JIMMY PATRONIS
CHIEF FINANCIAL OFFICER

PAM BONDI
ATTORNEY GENERAL

ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

MEMORANDUM

TO: Honorable Rick Scott
Honorable Jimmy Patronis
Honorable Pam Bondi

FROM: Ashbel C. Williams

DATE: September 14, 2017

SUBJECT: *Valeant Pharmaceuticals International, Inc.*

Pursuant to Rule 19-3.016(11), F.A.C., the purpose of the Memorandum is to bring to the Board a proposal to file a direct action against Valeant Pharmaceuticals International, Inc. Your offices have been provided with details and justification for the action.

Please contact me if you have any questions or need additional information.

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OF FLORIDA

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ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

MEMORANDUM

To: Ashbel C. Williams, Executive Director & CIO

From: Maureen M. Hazen, General Counsel Maureen M. Hazen

Date: September 6, 2017

Subject: Valeant Pharmaceuticals International, Inc. – Opt-Out and Filing of Direct Action

This Memorandum follows our recent discussions regarding the SBA opting out of the securities class action case and pursuing a direct action against Valeant Pharmaceuticals, Inc. ("Valeant"). Attached is an Analysis prepared by the law firm of Bernstein Litowitz Berger & Grossman LLP ("BLBG"), one of the law firms eligible to serve as securities litigation counsel to the SBA. I concur with BLBG's analysis and recommendation.

In my view, this is a highly meritorious case and the SBA will significantly and substantially enhance its recovery by opting out of the class case and pursuing a direct action. The SBA incurred over $62,000,000 in LIFO losses during the period relevant to the case, and the SBA would allege that all of these market losses are legally recoverable damages. In my view, if the SBA files a direct action, the SBA may be able to enhance its recovery above the class action recovery by double-digit millions of dollars.

As a result, I am recommending that the SBA opt-out of the class action case against Valeant and file a direct action against Valeant in the United States District Court for the District Court for the District of New Jersey.

BLB&G
Bernstein Litowitz
Berger & Grossmann LLP

Valeant Securities Fraud:

Case Plan and Analysis for Direct Action to Maximize Recovery of Damages

Prepared for:

Florida State Board of Administration

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September 1, 2017

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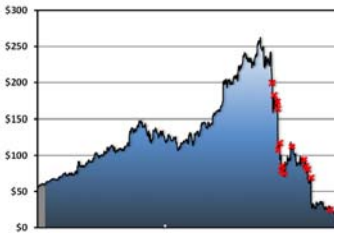


Relevant Period
1/4/13 – 8/10/16

Low / High	$18.55 - 263.81
$ Decline	$245.26
% Decline	93%
SBA's Estimated Damages	***$65 million FIFO*** ***$62 million LIFO***

Bernstein Litowitz Berger & Grossmann LLP ("BLB&G" or the "Firm") is pleased to provide this response to the request by the State Board of Administration of Florida ("SBA") for our case plan and analysis of the SBA's individual claims for recovery of damages arising from serious violations of the federal securities laws by Valeant Pharmaceuticals International, Inc. ("Valeant" or the "Company") and certain of its senior executives.

Based on BLB&G's extensive investigation of the merits of a Valeant direct action, our established track record of success resolving opt outs on behalf of institutional investors for substantial multiples of available class action recoveries, and the SBA's significant damages, BLB&G recommends that the SBA opt out of the pending securities class action against Valeant (the "Class Action") and pursue the direct resolution of its claims for recovery. As discussed in greater detail below, the SBA's individual claims are highly meritorious and, due to various factors, a direct action is highly likely to maximize the recovery of the SBA's significant damages compared to any eventual pro rata allocation of a common fund recovery in the Class Action.

The SBA incurred significant damages as a result of the fraudulent misrepresentations at Valeant. Based on a comprehensive analysis of the SBA's transactional data, our expert financial consultant determined that the SBA incurred potential recoverable damages of approximately ***$65 million FIFO*** and ***$62 million LIFO***—a financial interest that is among the largest of our public pension fund clients. Documents publicly on file with the Securities and Exchange Commission ("SEC") indicate that the SBA's losses are among the largest of any public fund investor.

We submit that BLB&G is uniquely qualified to represent the SBA in pursuing the direct resolution of its claims. BLB&G's unparalleled expertise in both class and direct action securities litigation includes over $31 billion in recoveries for investors since the Firm's founding in 1983, several hundreds of millions in direct action recoveries in the past several years, and, importantly, some of the most significant securities class actions in history in the same federal court – the United States District Court for the District of New Jersey – in which the Valeant securities litigation is pending. Indeed, BLB&G is honored to represent a number of other prominent institutional investors that have exercised their right to opt-out of the Valeant securities class action in order to pursue a direct resolution of their individual claims for recovery. In 2016, BLB&G filed strategic direct action complaints on behalf of T. Rowe Price, Teacher Retirement System of Texas, Principal Financial, Voya Financial, Alleghany Corporation, and many other

other institutional asset managers with substantial exposure to the Valeant securities fraud. *See T. Rowe Price Growth Stock Fund, Inc. et al. v. Valeant Pharms. Int'l, Inc. et al*., No. 16-cv-05034 (D.N.J. filed Aug. 15, 2016); *Equity Trustees Ltd.. et al. v. Valeant Pharms. Int'l, Inc. et al*., No. 16-cv-06127 (D.N.J. filed Sept. 26, 2016); *Principal Funds, Inc. et al. v. Valeant Pharms. Int'l, Inc. et al*., No. 16-cv-06128 (D.N.J. filed Sept. 27, 2016); *Bloombergsen Partners Fund LP. et al. v. Valeant Pharms. Int'l, Inc. et al*., No. 16-cv-07212 (D.N.J. filed Oct. 13, 2017) (the "Direct Actions"). In preparing these Direct Action complaints, BLB&G conducted an extensive investigation and carefully analyzed the merits of the direct action claims. Among other things, the Firm consulted with pharmaceutical and forensic damages experts and developed proprietary internal work product, including interviews of nearly three dozen former Valeant employees.

BLB&G's deep experience, thorough due diligence, proprietary investigation, and current representation of prominent institutional investors pursuing Valeant direct actions provides the SBA a tactical edge that will further enhance its ability to obtain maximum recovery. This is reflected below in our case plan for the Valeant direct action and borne out in the outstanding results we have achieved for our institutional investor clients in prior opt out matters. By way of example, BLB&G successfully represented prominent institutional investors in pursuing the direct resolution of their claims against Tyco, Marsh & McLennan, Countrywide, Quintus, and Qwest, among others. In each of these opt out matters, BLB&G's institutional investor clients recovered a material multiplier over the class recovery. BLB&G continues to represent many of the world's largest institutional investors in securities opt out litigation, including the Valeant matter and many other opt out cases pending in federal courts around the country. Here, we recommend that the SBA avail itself of the Firm's expertise in securities litigation and comprehensive investigation of the Valeant matter and file a detailed direct action complaint, in the same court as our pending Direct Actions, that is substantially similar to the comprehensive complaints on file in the Direct Actions. This should allow the SBA to avoid unnecessary risk, duplicative motion practice, and delay; benefit from favorable rulings in the Direct Actions and the Class Action; and join the pending litigations at (or near) a relatively advanced stage—i.e., the merits phase.

Finally, by pursuing an affirmative litigation strategy, the SBA will not only be in a position to hold Valeant and its senior executives accountable for the substantial losses they caused to the SBA, but also to insist on meaningful corporate governance reforms as an important component of any direct resolution with the Company. As discussed below, Valeant's repeated promises to improve transparency were empty, and it has yet to take any meaningful responsibility for its deception. Given Valeant's prominence in the pharmaceutical industry and the impact its practices have had on a strained American healthcare system, any corporate reforms achieved through this matter should have a lasting and meaningful impact.

Our detailed case plan and analysis is set forth below, including responses to each of the topics identified by the SBA. Additionally, we have attached as **Exhibit A** BLB&G's Direct Action brochure for your review, which outlines the Firm's focus on pursuing direct resolution of institutional investors' securities fraud claims as an avenue to maximize their recovery of damages. We have also attached as **Exhibit B** several draft proposals for meaningful corporate governance reforms, which address some of the most obvious failings at the Company and could be a component of any succesful resolution. We remain available to address any questions, and we would be honored to represent the SBA in a Valeant direct action.

The SBA's Estimated Losses and Potential Damages

Valeant shares are dual-listed on the NYSE and the Toronto Stock Exchange. Based on a comprehensive analysis of the SBA's updated transactional data, our outside forensic expert has determined that the SBA incurred substantial losses and potential damages on purchases of Valeant shares between January 4, 2013 and August 10, 2016 (the "Relevant Period"). As reflected in the table below, the SBA incurred total losses and potential recoverable damages of approximately **$65 million FIFO** and **$62 million LIFO** on its purchases of Valeant shares during the Relevant Period, with the gravity of the exposure in the U.S.-listed shares.

The SBA's Potential Recoverable Damages

	FIFO	LIFO
U.S. Shares	$55,426,443	$54,615,931
Canadian Shares	$9,658,680	$7,499,755
Total	***$65,085,123***	***$62,115,686***

Given that the SBA's losses and potential damages are concentrated in the U.S.-listed shares, the focus of the SBA's direct action should be recovery of losses incurred on Valeant's U.S.-listed shares under the federal securities laws. These include general antifraud claims under Section 10(b) of the Exchange Act and related "control person" claims under Section 20(a) of the Act, which the Court has already sustained in the Class Action case over Defendants' motion to dismiss.

In performing this updated preliminary analysis of the SBA's potential damages under the federal securities laws, our financial expert constructed an "event study" model that considers whether other factors such as market and industry forces could have caused the losses. The damages model uses a statistical analysis to determine whether a pre-defined disclosure or event caused a statistically significant change in the price of Valeant shares. After extracting the predicted effects of general equity market and industry-specific price changes, the residual Valeant-specific price changes were measured for statistical significance. Thus, the event study model statistically isolates the price effect of Valeant-specific information to assess whether that effect can be deemed material under the federal securities laws and prevailing econometric literature. Residual price changes applied to the SBA's specific transactional data determine the SBA's potential recoverable damages. Significantly, the results of our expert's "event study" and statistical regression analysis show a very high statistical significance at the 95% - 100% confidence level for each of the stock price declines associated with alleged corrective disclosures. The total abnormal dollar change for all of the corrective dislcosure events approaches Valeant's actual dollar change over the disclosure time period – ***meaning that the vast majority of the SBA's losses suffered as a result of Valeant's***

series of negative disclosures can be claimed as recoverable under prevailing economic methodologies approved by the federal courts.

Developments in the Valeant securities litigation support our financial consultant's damages model. All of the potential corrective disclosures identified by our financial consultant during the class period and included in our financial consultant's damages model were included in the Lead Plaintiff's Consolidated Class Action Complaint, and were sustained by Judge Shipp at the pleading stage over all of Defendants' challenges. *In re Valeant Pharm. Int'l, Inc. Sec. Litig.*, 2017 WL 1658822, at *12 (D.N.J. Apr. 28, 2017). Further, in our opt out cases, Defendants have filed extremely limited motions to dismiss. In essence, Defendants proffer only one argument—that plaintiffs' securities fraud claims should exclude shares purchased after October 2015 because "Valeant's alleged omissions were fully disclosed to the market" by then. We believe this argument lacks factual and legal merit and that the Court will reject it, as it has every other one of Defendants' pleading challenges. Even if the Court were to accept this argument and exclude from the securities fraud claims all post-October 2015 purchases, the impact to SBA's opt out claims would be negligible: only about 5% of the SBA's damages arise from purchases after October 2015.

The ultimate recovery in this matter will be based on the evidence obtained through discovery, further expert damages analyses, court rulings on procedural and substantive matters impacting the scope of investors' claims, as well as a range of other factors. However, based on our experience in similar securities fraud cases against pharmaceutical companies, we believe the SBA will be able to recover a material portion of the amounts listed above. For example, in the *Cendant* securities class action, an accounting fraud action prosecuted by our Firm in the District of New Jersey (the same Court presiding over the Valeant securities litigation), we recovered approximately 37.5% of investors' estimated damages. Another example is the *Biovail* securities litigation against Valeant predecessor Biovail Corporation, in which the Firm recovered $138 million on behalf of investors, representing approximately 18.5% of the class's estimated damages. It bears emphasis that these extraordinary recovery percentages were obtained by BLB&G when representing the lead plaintiff and investor classes in securities class actions. However, BLB&G has achieved substantially higher recovery percentages when selectively representing prominent institutional investors (including the SBA) in direct actions. BLB&G has an established track record of success representing individual investors in direct actions – including Countrywide Financial, Tyco International, Qwest Communications, Quintus, and Marsh & McLennan – where we have served as counsel to some of the world's largest and most prominent institutional investors and obtained ***material multipliers*** on the available class action recoveries.

While we believe each securities fraud case rests on its own merit and the class recovery is largely dependent on a number of variable factors (i.e. strength of liability claims, ability to pay, lead plaintiff, lead counsel, judge, venue, etc.), a recent analysis on securities class action settlements by NERA Economic Consulting reports a median settlement of just 0.6% of estimated losses for securities fraud class actions involving market capitalization losses in excess of $10 billion. Applying NERA's median class action settlement percentage of 0.6% for cases of this size to the SBA's FIFO and LIFO estimated damages as

calculated by our damages expert, ***the SBA's estimated recovery in the Valeant Class Action would be only approximately $390,500.***

With respect to the SBA's estimated recovery in a Valeant direct action, based on the above-referenced class action benchmarks against pharmaceutical companies, our experience in direct actions generally, the merits of this action in particular, the availablity of direct claims to recover damages on Canadian shares, and the group of prominent institutional investors expected to pursue this action with BLB&G, we believe that the SBA can reasonably expect to achieve a ***significant premium*** to its estimated Class Action recovery when pursuing its direct claims as part of BLB&G's institutional investor direct resolution group.

Degree and Severity of the Wrongdoing

The action against Valeant is a compelling case arising out of egregious misconduct at one of the world's largest and most prominent pharmaceutical companies. The case stems from a fraudulent scheme perpetrated by Valeant and its top executives to use a secret network of captive pharmacies to shield the Company's drugs from competition, fraudulently inflate the prices of its products, and artificially boost sales. Valeant and its secret pharmacy network provided a platform through which Defendants implemented a host of fraudulent practices to improperly inflate the reimbursements for Valeant drugs paid for by Medicare and Medicaid, private health insurers, pension health care funds, and other third-party payors ("TPPs"). The fraud Valeant perpetrated through its secret pharmacy enterprise was so vast and devastating that media and commentators have dubbed it the "Pharmaceutical Enron."

Unlike traditional pharmaceutical companies, Valeant's business model has not been focused on the research and development of new drugs. Instead, the Company's business model, conceived by Michael J. Pearson, Valeant's CEO during the Relevant Period, was founded on acquiring promising drugs from other pharmaceutical companies and utilizing Valeant's captive pharmacy network to make those drugs more profitable. With Pearson at its helm, Valeant went on a buying spree, acquiring numerous drug makers, stuffing their patents and trademarks in tax shelters, firing their scientists, and disposing of underperforming drugs. Valeant's strategy appeared to be enormously successful: under Pearson's leadership, the price of Valeant stock exploded by over 1,000%.

The key to Valeant's success was the Company's practice of massively raising the prices of drugs it obtained through its serial acquisitions. Indeed, Valeant increased the price of at least 18 drugs by 250% or more over the course of the less-than-two-year Relevant Period. For instance, Valeant raised the price of Carac cream and Tagretin gel, two dermatology drugs, by ***557%*** and ***250%***, respectively. While these price increases were public, Valeant went to great lengths to mislead the public regarding the misconduct at Valeant's secret enterprise of controlled-pharmacies that facilitated those price increases. Indeed, Valeant went to great lengths to conceal its secret pharmacy network, which was essential to the successful implementation of these price increases.

Far cheaper generic equivalents are available for most of Valeant's drugs. For instance, while Valeant charges ***$17,000*** for a year's supply of branded Wellbutrin, a year's supply of the drug's generic equivalent costs ***only $360***. Absent the scheme Defendants implemented through the Valeant pharmacy network, Valeant's bloated drug prices would have been unsustainable in the face of competition from these cheaper generic alternatives. Many state laws, and many contracts entered into by and on behalf of TPPs, require such substitution unless precluded by the prescribing physician. Moreover, because TPPs and pharmacy benefit managers ("PBMs") generally require a patient co-pay to provide patients with a cost incentive to avoid expensive or unnecessary drugs, consumers have an economic interest in selecting cheaper generics where available. Accordingly, patients would have sought out, and dispensing pharmacies would have substituted, generic prescriptions for Valeant's brand-name drugs.

The secret pharmacy network at the heart of Valeant's fraudulent scheme was created specifically to circumvent the problem of generic competition. The Valeant enterprise operated to enable Valeant management to control the distribution of the Company's expensive branded drugs and thereby frustrate generic substitution mandates, most importantly to ensure that generics were substituted for Valeant products as infrequently as possible.

Valeant built its secret network of captive pharmacies around Philidor Rx Services, LLC ("Philidor"), a Pennsylvania mail order pharmacy. Valeant then created a host of shell companies owned through Philidor, which Philidor used to acquire interests in additional retail pharmacies all over the United States.

With its secret pharmacy network in place, the Company channeled prescriptions for its branded drugs – particularly those that were especially susceptible to generic competition, like the Company's dermatological products – through Philidor. Philidor employees, as well as Valeant employees staffed at Philidor under aliases, were instructed to employ a host of fraudulent practices to prevent the substitution of cheaper generic equivalents for Valeant branded drugs. Such conduct was often in contravention of state laws and contractual mandates requiring such substitution. As a direct consequence of the scheme, TPPs paid highly inflated prices for Valeant's expensive branded drugs, in many cases notwithstanding the availability of far cheaper generic drugs that could have, and should have, been dispensed.

During the Relevant Period, Valeant engaged in a host of serious misconduct in furtherance of the fraudulent scheme:

- Valeant secretly developed a nationwide network of captive pharmacies, and placed Valeant employees at those pharmacies using aliases to conceal their identity;
- Valeant management instructed Philidor employees to changes codes on prescriptions to ensure they would be filled with a Valeant drug, rather than a generic equivalent;
- Valeant used false pharmacy identification information to bill TPPs for prescriptions in order to fraudulently bypass the TPPs' denials of claims for reimbursements;

- Valeant submitted numerous prescription renewals for reimbursement, falsely representing to TPPs and PBM agents that patients had requested renewals of their prescriptions when no such request had been made;
- Valeant waived patient co-pays to remove patients' incentive to seek out cheaper drugs, and then misrepresented the "actual charges" by failing to account for the co-pay waivers;
- Valeant used pharmacies within its captive network to enable Philidor to indirectly operate in states where it had been denied a license; and
- Valeant employees made misrepresentations directly to patients in order to boost drug sales.

Many of these fraudulent practices are catalogued in claims handling manuals Defendants distributed to Philidor employees, assuring those employees that "[w]e have a couple of different 'back door' approaches to receive payment from the insurance company." As explained in further detail below, those "back door approaches" included: (1) changing prescription codes on claims i.e., deliberately altering the prescribing doctor's instructions as set forth in the prescription in order to receive payment – to require that the prescription be filled with Valeant's brand-name drugs, as opposed to less expensive generic alternatives; (2) making claims for refills that were never requested by patients – a scheme that former Philidor employees have confirmed was jointly developed by top Valeant and Philidor executives; (3) misrepresenting the identity of dispensing pharmacies in order to bypass denials of claims for Valeant drugs – a fraudulent practice that Andrew Davenport, Philidor's CEO, acknowledged in a July 19, 2015 email he knew was ongoing; and (4) submitting claims that inflated the price charged to patients by failing to take into account serial waivers of patient co-pays.

The success of Defendants' scheme hinged on its secrecy: had TPPs or PBMs known the truth about Defendants' captive pharmacy network, they would have denied claims submitted by pharmacies in the Valeant Enterprise and scrutinized Defendants' practices. Moreover, had state regulators known the truth about the existence of the secret pharmacy network and its use by Valeant to increase revenues, the Company would have come under intense scrutiny for its business practices. To maintain the secrecy of its captive pharmacies, Valeant issued a host of false and misleading statements to a number of constituencies, including investors, regulators, and TPPs, designed to conceal Valeant's relationship with its captive pharmacies and its improper use of the secret pharmacy network to inflate drug prices and sales. During its investigation, several Philidor and Valeant employees interviewed by BLB&G attorneys shared common accounts detailing Valeant's control of Philidor and its efforts to conceal the relationship, noting internal policies that prevented employees from Valeant from mentioning Philidor to customers, and vice versa.

Through its fraudulent scheme, Valeant reaped hundreds of millions of dollars in ill-gotten profits at the expense of those who paid inflated prices for Valeant drugs that should never have been dispensed. Indeed, in 2015 alone, Valeant secretly channeled nearly $500 million of its drugs through its central pharmacy hub, Philidor.

The fallout from the unmasking of Valeant's secret pharmacy network in Fall 2015 has been devastating. Shortly after Valeant's relationship with Philidor was revealed, the three largest pharmacy benefit managers in the U.S., CVS Health Corp., Express Scripts Holding Co., and UnitedHealth Group Inc.'s OptumRx, each announced that they were dropping Philidor from their networks. They also disclosed that audits revealed that Philidor had failed to comply with terms of their agreements. In October 2015, Valeant announced that it had terminated its relationship with Philidor. After news about the secret pharmacy network reached investors – and the Company failed to provide reasonable explanations for the existence and secrecy of that network – Valeant lost over $76 billion of its market capitalization.

Valeant is now under ***criminal investigation*** by the U.S. Department of Justice Department. Federal prosecutors in Manhattan, Boston, and Philadelphia are reportedly building criminal cases against Valeant and certain of its former executives – including Defendant Pearson, the Company's former Chairman and CEO, and Defendant Schiller, its former CFO and interim CEO – related to Valeant's secret pharmacy network and improper distribution, billing, and fulfillment practices. Valeant has acknowledged in public statements that it is "fully cooperating" with authorities. Moreover, in November 2016, federal prosecutors in Manhattan filed criminal charges against Gary Tanner, Valeant's former Executive Director of Commercial Analytics, and Andrew Davenport, the founder and former CEO of Philidor, the specialty mail-order pharmacy at the heart of Valeant's secret pharmacy network. The Justice Department's complaint asserts charges for wire fraud, money laundering, and conspiracy arising out of a multi-million dollar fraud and kickback scheme. If convicted on all counts, Tanner and Davenport face a maximum of 65 years in prison. In addition to the Department of Justice, Congress and the SEC, among others, are investigating Valeant's improper conduct.

Factual and Legal Merits of the Case

a. Summary of the Fraud

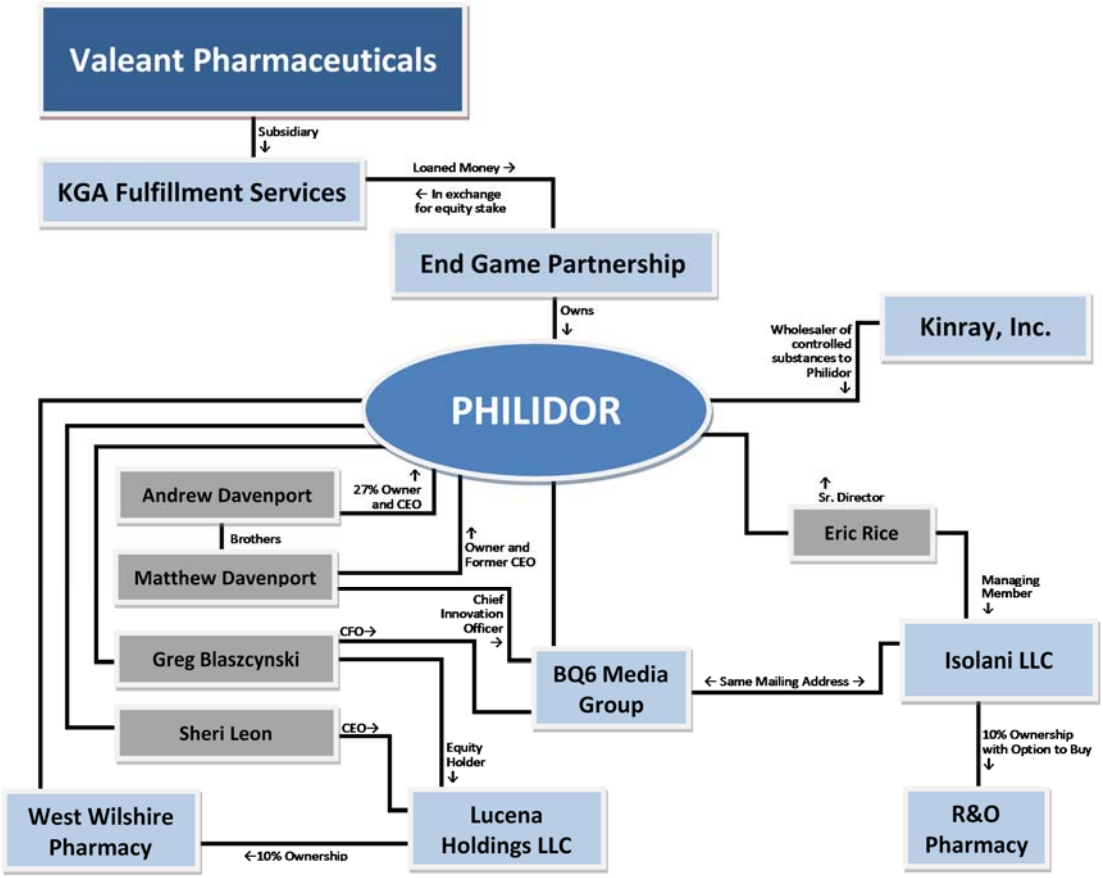
Based in Quebec, Valeant is a multinational pharmaceutical company that manufactures and markets a broad range of pharmaceutical products primarily in the areas of dermatology, gastrointestinal disorders, eye health, neurology, and branded generics. In February 2008, Valeant hired Michael Pearson ("Pearson") to serve as its Chief Executive Officer. Over the next several years, Pearson expanded the Company's growth by implementing an aggressive acquisition strategy through which Valeant acquired pharmaceutical companies and substantially increased the prices of their established branded drugs. But such a strategy is impossible where low-cost generic alternative drugs exist. In order to insulate its brand name drugs from generic competition, particularly within its dermatology segment, Valeant embarked on a scheme to funnel sales of its branded drugs through a captive network of specialty pharmacies that the Company controls.

Unlike other pharmaceutical companies which use specialty pharmacies to distribute specialty medications designed to treat complex or rare diseases like cancer or HIV, Valeant relies on its specialty pharmacy network—Philidor—primarily to distribute the Company's dermatology products, some of which

are cosmetic and most of which have low-cost generic alternatives. Significantly, the Company's ownership of Philidor and other specialty pharmacies was never disclosed to investors during the Relevant Period. To the contrary, throughout the Relevant Period, the Company consistently reported massive sales growth, including significant growth within Valeant's dermatology segment, which comprises nearly 25% of Valeant's annual revenue. The Company attributed this enormous growth to, among other things, its outstanding sales teams, its innovative marketing approaches, great leadership, and the overall quality of its products.

In truth, however, Valeant's sales growth was driven by (among other things) the aggressive, potentially illegal, and undisclosed actions of its captive network of specialty pharmacies. As set forth above, once Philidor was established, Valeant used its influence and control over the specialty pharmacy to boost sales of its branded drugs in several questionable and potentially illegal ways including changing prescriptions, improperly waiving copays, and recording "phantom sales."

VALEANT'S SECRET NETWORK OF CAPTIVE SPECIALITY PHARMACIES



Significantly, Valeant's aggressive, highly questionable, and potentially illegal marketing and "reimbursement" practices extended beyond the Company's captive pharmacy network. For example,

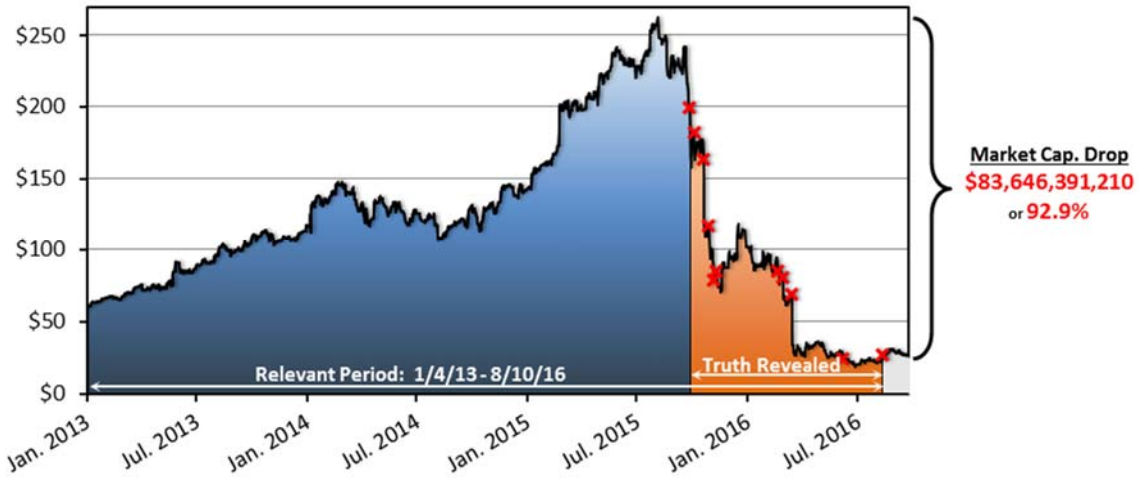
Valeant maintained a variety of "patient-assistance programs" and "volume-based" assistance programs that allowed the Company to keep prices high while claiming that it was serving patients. In truth, numerous patients and providers do not qualify for these programs. Moreover, as Senator Elizabeth Warren and other lawmakers recently emphasized during a Senate hearing into Valeant's questionable sales practices, these programs cannot be used with Medicare or other government insurance because "they're illegal."

Beginning in September 2015, Valeant's control of those specialty pharmacies (which are illustrated in the chart above), the sales practices it was able to employ as a result of that undisclosed control, and additional questionable and undisclosed sales practices that it utilized across its operations were revealed to investors through a series of disclosures by the Company, as well as reports by several analysts, investigations by government agencies, and private litigation. These disclosures revealed an apparent accounting fraud and called into question the sustainability of Valeant's business. Specifically, between September 2015 and August 2016, Valeant disclosed, among other things, the following facts which strongly indicate that Valeant engaged in an intentional fraud:

- Valeant admitted to paying $133 million for an option to purchase Philidor at a later date for no additional compensation. In other words, Valeant purchased Philidor, but disguised the transaction as an option to further conceal its ownership of the specialty pharmacy.
- Valeant exercised significant control over Philidor and placed its own employees within the specialty pharmacy, but had them use aliases to conceal their identities.
- Employees at the specialty pharmacies admitted that they modified prescriptions to mandate the sale of branded drugs rather than generics.
- After the California Board of Pharmacy denied Philidor's license application, Philidor secretly acquired R&O—an existing California pharmacy—and illegally used its multistate license to distribute Valeant products in California.
- R&O's owner alleged that Philidor issued invoices through his pharmacy that he never fulfilled.
- Valeant later admitted that its organic growth was driven by its reliance on the specialty pharmacies, which it secretly owned.
- Valeant has disclosed that it will restate its financial results for all of 2014 and the first quarter of 2015 due to improperly-recognized revenue related to Philidor.
- Valeant has terminated its longtime CEO, Pearson, who was responsible for the Company's growth-by-acquisitions strategy, and ordered Pearson to cooperate with a Senate investigation.
- Valeant has blamed its accounting errors on the "improper conduct" of the Company's former CFO and Corporate Controller – and the unethical "tone at the top" by senior management.
- In the wake of the above disclosures, Valeant slashed its guidance for FY 2016 by nearly half, warned of potential bank-loan and bond defaults due to failure to issue audited financials, delayed its annual report, and confirmed an SEC probe.

And, on August 10, 2016, the *Wall Street Journal* reported that Valeant is under criminal investigation by the Department of Justice.

The market was shocked by these disclosures, with analysts describing Valeant's network of captive specialty pharmacies as "aggressive and questionable" and unprecedented in the industry. The disclosures caused Valeant shares to plunge over 90% from Relevant Period highs, wiping out over ***$83 billion*** of shareholder value, as set forth in the charts below:



Based on BLB&G's proprietary investigation and consultation with outside financial experts, we believe that investors will have little difficulty demonstrating that most of these losses were a foreseeable consequence of the fraudulent conduct and thus give rise to recoverable damages under the federal securities laws.

b. Legal Merits of the Case

The case against Valeant is highly meritorious. We believe that Valeant's securities and accounting fraud gives rise to liability under a number of powerful claims under the federal securities laws, including Sections 10(b), 18, and 20(a) of the Securities and Exchange Act of 1934 (the "Exchange Act"). Indeed, the Court presiding over the Valeant securities litigation has already sustained the sufficiency of the allegations supporting investors' core claims for recovery over Defendants' motions to dismiss--including ***all*** of investors' securities fraud claims under the Exchange Act.

(1) The Court Has Upheld The Allegations Supporting Investors' Claims For Recovery

On April 28, 2017, the federal District Judge overseeing the Valeant securities class and individual litigation substantially denied Defendants' motions to dismiss Lead Plaintiffs' Consolidated Class Action Complaint. *In re Valeant*, 2017 WL 1658822. Prior to ruling on the motions to dismiss, the Court received 17 briefs totaling over 425 pages, including more than 70 exhibits and 48 pages of appendices, and heard

nearly four hours of oral argument. After "carefully considering" these materials and the parties' opening and rebuttal arguments, the Honorable Michael A. Shipp issued a cogent opinion that:

- ***Upheld*** plaintiffs' principal anti-fraud claims under Exchange Act Section 10(b) and SEC Rule 10b-5, and related "control person" claims under Exchange Act Section 20(a). Judge Shipp found that plaintiffs sufficiently pled the core elements of scienter (fraudulent intent), materiality, and loss causation against all of the Exchange Act defendants; and
- ***Upheld*** plaintiffs' strict liability claims under Securities Act Section 11, and related control person claims under Securities Act Section 15, for recovery of damages on Valeant stock purchased in Valeant's March 2015 secondary offering. Judge Shipp found that plaintiffs adequately alleged standing and actionable false statements in the Registration Statement for the May 2015 stock offering as against all of the Section 11 defendants.

The ***only*** claim that the Court dismissed – without prejudice – was plaintiffs' claim under Securities Act Section 12(a)(2) for recovery of damages incurred on certain Valeant debt securities sold in private Rule 144A offerings. Notably, the SBA did not invest in Valeant debt securities.

(2) Evaluation of Claims and Potential Defenses

(a) Securities Fraud Claims Under Section 10(b) of the Exchange Act

Investors' primary claims are for securities fraud under Section 10(b) of the Exchange Act. To sustain a claim under Section 10(b), a plaintiff must prove: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37-38 (2011).

Notwithstanding Defendants' absolute failure at the pleading stage to have any aspect of the Section 10(b) claims dismissed or otherwise restricted, Defendants will likely continue to argue that plaintiffs cannot establish that they made materially false statements of fact, scienter, and loss causation. Specifically, Defendants will likely argue that they are not liable because the federal securities laws do not establish a duty for a company to disclose all material information, and that all of its statements were true when made. Further, Defendants will likely attempt to argue that plaintiffs cannot establish scienter by disclaiming knowledge of the fraud and blaming the misconduct on Philidor, which Valeant will contend it did not control. Lastly, we expect that Defendants will vigorously contest investors' loss causation allegations by arguing, among other things, that disclosures relating to scrutiny of Valeant's practice of increasing drug prices do not relate to Valeant's specialty pharmacy network. As noted, Judge Shipp has already rejected each of these defenses at the pleading stage, and we believe these defenses will also likely fail at summary judgment and at trial.

(i) Materially False and Misleading Statements

One of the most fundamental elements necessary to recover damages for a claim under Section 10(b) is to demonstrate that the defendant made a false or misleading statement or omission of material fact. Here, Valeant's misrepresentations center on the Company's deliberate misrepresentations regarding its organic sales growth, which the Company repeatedly claimed was driven by, among other things, its sales teams, innovative marketing approaches, and the overall quality of its products. In truth, it now appears clear that Valeant's growth was, in fact, driven by the Company's control over a captive network of specialty pharmacies, which it used to insulate its high-priced drugs from generic competition and possibly to facilitate the booking of phantom sales. We anticipate that, following discovery, the Company will attempt to show that all of its statements were true at the time they were made or were immaterial, and, further, that the federal securities laws did not create a duty to disclose Valeant's control of Philidor. We believe that Defendants' contentions will fail.

Although a company does not generally have a duty to disclose all material information to the public, a duty to disclose does arise where a defendant makes "an inaccurate, incomplete or misleading prior disclosure." *Oran v. Stafford*, 226 F.3d 275, 285-86 (3d Cir. 2000); *see also In re Craftmatic Sec. Litig.*, 890 F.2d 628, 641 (3d Cir. 1989) ("In addition to the duty to disclose specific information required by law . . . Rule 10b-5 impose[s] upon defendants the duty to disclose any material facts that are necessary to make disclosed material statements, whether mandatory or volunteered, not misleading."). In other words, once a company or corporate executive chooses to speak, they are "bound to speak truthfully." *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 282 (3d Cir. 1992). Significantly, a statement regarding successful financial performance, even when accurate, is still misleading under the securities laws if the speaker "attribut[es] the performance to the wrong source." *In re ATI Techs., Inc. Sec. Litig.*, 216 F. Supp. 2d 418, 436 (E.D. Pa. 2002). Here, Defendants' arguments that they did not have a duty to disclose their deceptive practices as a matter of law have already failed at the pleading stage. This is not surprising, given that Defendants put the integrity of their business practices into play by specifically denying that Valeant's practices were unsustainable and affirmatively representing that the Company's growth-by-acquisitions business model was "low risk." *See Shapiro*, 964 F.2d at 282("[I]f a defendant represents that its lending practices are 'conservative' and that its collateralization is 'adequate,' the securities laws are clearly implicated if it nevertheless intentionally or recklessly omits certain facts contradicting these representations.").

Similarly, statements concerning the cause for Valeant's surging growth, particularly within its dermatology segment, are demonstrably false because they misrepresent the reason for that growth, which was driven by Valeant's reliance on specialty pharmacies it secretly controlled. Using the specialty pharmacies allowed Valeant to continue to grow sales of its expensive branded dermatology products, while insulating itself from competition from significantly less expensive generic alternatives. As a result, the Company's statements attributing its growth to "innovative new marketing approaches," the "outstanding work of [their] sales teams," the quality of its products, or touting its expectation and ability to continue to

grow sales, are actionably false. *See, e.g.*, *City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.*, 713 F. Supp. 2d 378, 389 (D. Del. 2010) (statements that attribute company's revenue growth to purely legitimate business practices "are false or misleading under the securities laws" when revenue growth was driven, in part, by a price-fixing conspiracy); *In re Providian Fin. Corp. Sec. Litig.*, 152 F.Supp.2d 814, 824-25 (E.D. Pa. 2001) (statements that attribute the company's good fortunes to its "customer focused approach" puts the topic of the cause of the company's success in play creating an "obligat[ion] to disclose information concerning the source of its success, since reasonable investors would find that such information would significantly alter the mix of available information").

Similarly false are Defendants' statements regarding the independence of Philidor and statements normalizing Valeant's relationship with Philidor. The refusals of PBMs to reimburse Philidor prescriptions and Philidor's closure when the scandal was revealed indicate that Valeant's use of Philidor was not "similar" to other pharmaceutical companies, as Defendants represented. After the fraud was revealed, media reports commented that Valeant had a relationship with Philidor that "other [drug] companies don't appear to have."

Defendants' contention that revenue from products sold through Philidor was just 7% of Valeant's total revenues, and therefore not a material portion of their business, also lacks merit. Under GAAP, any restatement is by definition material. SFAS 154. Further, courts have held that "[s]etting up a *per se* numerical bar to materiality – whether five percent of sales or otherwise – runs counter to the guidance of the Supreme Court and several federal Circuit Courts of Appeal, which have described materiality as an 'inherently fact-specific finding,' defying 'formulaic' assessment." *In re Ply Gem Holdings, Inc. Sec. Litig*., 2016 WL 5339541, at *4-5 (S.D.N.Y. Sept. 23, 2016) (finding defendants' alleged omissions that amounted to less than 5% of Ply Gem's net sales were material); *Ganino v. Citizens Utils. Co*., 228 F.3d 154, 162 (2d Cir. 2000) (reversing the district court's ruling that a misrepresentation implicating fees totaling 1.7% of the company's total revenue was immaterial as a matter of law). Moreover, in assessing the materiality of a financial restatement, the court considers both quantitative and qualitative factors. *See, e.g.*, *Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 714 (2d Cir. 2011). Here, the qualitative factors strongly favor a finding of materiality because the errors were directly related to Valeant's concealment of an unprecedented network of captive pharmacies used to artificially boost the Company's sales and revenues, the revelation of which would "call into question the integrity of the company as a whole." *In re Petrobras Sec. Litig*., 116 F. Supp. 3d 368, 380 (S.D.N.Y. 2015) (quotation omitted). Indeed, as *Bloomberg* reported, Valeant's financial arrangement with Philidor "was at the heart of Valeant's eventual share meltdown."[1]

[1] As an analyst from Wells Fargo reported, despite the Company's claim that Philidor accounted for only 7% of Valeant revenues, Valeant lowered revenue guidance by 17%-19% in 4Q15 and EPS guidance by 37%. The Well Fargo analyst noted that "Valeant has not explained how the unwinding of a business that represents approximately 7% of total revenue, and is, according to Valeant, less profitable than traditional prescriptions, results in a 36.6% reduction in EPS" and that Valeant's "new guidance is not compatible with the data presented by Valeant."

Further, reports indicate that Valeant would not have met its EPS guidance for certain quarters without the extraordinary price increases for products sold through Philidor and other captive specialty pharmacies. *See New Orleans Employees Ret. Sys. v. Celestica, Inc.*, 455 F. App'x 10, 16 (2d Cir. 2011) (finding misstatements concealing a failure to meet analyst expectations relating to an issue significant to the company's operations that caused the stock price to decline once revealed were material). Here, in finding materiality adequately pleaded, Judge Shipp stated that Valeant's numerous misstatements and omissions regarding its purported deceptive practices were important to the reasonable investor. *In re Valeant*, 2017 WL 1658822, at *12.

Finally, Valeant cannot seriously dispute that statements concerning the Company's reported financial results, Sarbanes-Oxley ("SOX") certifications, and other statements about the purported adequacy of Valeant's internal controls were materially false when made. Under GAAP, restatements are ***only*** allowed to correct material misstatements. Statement of Financial Accounting Standards ("SFAS") No. 154, Accounting Changes and Error Corrections ("SFAS 154"). Here, Valeant has restated its financials for all of 2014 and the first three quarters of 2015 due to improper recognition of $58 million in Philidor-derived revenues, and, relatedly, that its internal controls suffered from multiple material weaknesses and deficiencies. Valeant and the Individual Defendants have now acknowledged that Valeant's internal controls suffered from several material weaknesses, including an improper "tone at the top." The Company cites its failure to maintain effective controls as a contributing factor in its overstatement of revenues. Valeant's admission of a lack of effective controls at the Company establishes the falsity of the Relevant Period financial statements and SOX certifications. Given that Valeant has admitted that its internal control deficiencies were "material weaknesses," any argument that statements praising the Company's internal controls and financial compliance were immaterial carries little weight. *See In re Atlas Air Worldwide Holdings, Inc. Sec. Litig*., 324 F. Supp. 2d 474, 486-87 (S.D.N.Y. 2004) ("the mere fact that financial results were restated is sufficient basis for pleading that those statements were false when made."). Accordingly, we believe investors will have little trouble establishing the elements of materiality and falsity for statements concerning Valeant's financial results, SOX statements and other statements about the adequacy of the Company's internal controls during the Relevant Period.

Accordingly, we believe that Defendants' contentions regarding the elements of materiality and falsity lack merit and investors will be able to sufficiently establish that Valeant's statements were actionably false.

(ii) Scienter

Scienter—widely considered to be the most difficult element of a securities fraud claim to establish—is the requirement that defendants acted with a culpable state of mind when making the alleged materially false misstatements or omissions of fact. The PSLRA requires a securities fraud complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with" scienter. 15 U.S.C. § 78u-4(b)(2)(A); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (Ginsburg, J.) ("[a] complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at

least as compelling as any plausible opposing inference one could draw from the facts alleged."). *Id.* at 324. "Scienter is a mental state embracing intent to deceive, manipulate, or defraud, and requires a knowing or reckless state of mind." *Institutional Inv'rs Grp. v. Avaya, Inc.*, 564 F.3d 242, 252 (3d Cir. 2009) (citations and quotations omitted). In the Third Circuit, a "reckless statement is one involving . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *In re Fisker Auto. Holdings, Inc. S'holder Litig.*, 2015 WL 6039690, at *20 (D. Del. Oct. 15, 2015) (citation omitted). Here, Judge Shipp has already found that investors' detailed allegations of fraud meet the PSLRA's and Rule 9's exacting standards for pleading fraud. *In re Valeant*, 2017 WL 1658822 at *11.

Valeant's Scheme was Known at the Highest Levels of the Company

We believe discovery will clearly show that Defendants acted with fraudulent intent. There are already numerous facts indicating that, from the start of the Relevant Period, Defendants knew that the Company had substantial influence and control over a captive network of specialty pharmacies that employed aggressive, and possibly illegal, tactics to drive revenue growth. We now know that Pearson's own deputy—Executive Vice President Laize Kornwasser—was hired by Pearson to oversee the creation and expansion of Philidor. In turn, Kornwasser, who was one of a few Valeant executives that reported directly to Pearson, oversaw an operation that illegally modified prescriptions to mandate the sale of branded drugs rather than generics, and issued invoices using the license of a local California pharmacy that the local pharmacist never fulfilled.

Moreover, Defendant Pearson admitted to knowing about the Company's direct financial interest in Philidor, but withheld that information from investors, dubiously citing the Company's need to maintain its competitive advantage. More likely, Defendants knew that their substantial reliance on the secret specialty pharmacy network was unprecedented in the industry and did not want to draw attention to its aggressive and potentially illegal activity. This inference is supported by Defendants' efforts to keep its relationship and financial interest in Philidor and other specialty pharmacies secret. Philidor's license application was denied in May 2014 after the California Board of Pharmacy accused the company and its representatives of making "false statements of fact" for failing to disclose its relationship with Valeant. Valeant also placed its own employees within Philidor, but had them use aliases to conceal their identities. The Company's efforts to conceal its relationship and reliance on the specialty pharmacies are strongly indicative of Defendants' scienter. *See, e.g.*, *Brown v. China Integrated Energy, Inc.*, 875 F. Supp. 2d 1096, 1124 (C.D. Cal. 2012) ("evidence of concealment is strongly indicative of scienter") (citation omitted). Defendants' even concealed the fraud from Bill Ackman and his Pershing Square hedge fund, one of Valeant's largest investors, who unwittingly praised the Company in testimony before Congress and emailed Pearson and other executives that they looked "like Enron."

Further indicating a scheme to keep the Philidor relationship secret, investigators for BLB&G interviewed a Philidor employee who was reprimanded for mentioning a connection between Valeant and

Philidor to a customer by Brad Greenfield ("Greenfield"), a Philidor manager reporting directly to Philidor CEO Andrew Davenport ("Davenport"). Greenfield told the employee that her conduct - mentioning Valeant on the phone to a customer - was "putting the entire business at risk" and gave the employee a written warning, which she was not allowed to keep a copy of. Several other Philidor and Valeant employees interviewed by BLB&G provided similar accounts exemplifying Valeant's control of Philidor and Valeant's efforts to conceal the relationship, noting internal policies that prevented employees from Valeant from mentioning Philidor to customers, and vice versa. A former Valeant employee interviewed by BLB&G recalls at least ten employees being "promoted" to Philidor from Valeant and stated that the primary function of Philidor sales representatives was to ensure that Valeant's products were sold through Philidor. Additionally, several former employees revealed that patients often called Philidor to complain about the price of Valeant pharmaceuticals and other improper Philidor practices. In the Senate Committee Hearings, Pearson admitted he tracked "every" patient that called to complain about the price of pharmaceuticals, further indicating that he was aware of the improper practices at Philidor and wanted to conceal Valeant's involvement.

Next, the Company has acknowledged that its "improper revenue recognition" related to Philidor was not innocently made, but rather was the result of the "improper conduct" of the Company's former CFO and former Corporate Controller. Additionally, Valeant has attributed as a "contributing factor" to its ineffective controls over financial reporting the unethical "tone at the top" by senior management. On March 21, 2016, the Company issued a press release and filed a Form 8-K with the SEC stating that:

> *"The **improper conduct** of the company's former chief financial officer and former corporate controller, which resulted in the provision of incorrect information to the committee and the company's auditors, contributed to the misstatement of results. In addition, as part of this assessment of internal control over financial reporting, the company has determined that the **tone at the top of the organization** and the performance-based environment at the company, where challenging targets were set and achieving those targets was a key performance expectation, may have been contributing factors resulting in the company's improper revenue recognition."*

Valeant's 2015 Form 10-K, filed with the SEC on April 29, 2015, confirms the Company's ineffective financial controls by including the existence of two separate material weaknesses as of December 31, 2014 (i.e., the improper "tone at the top" and the failure to detect the Philidor accounting fraud). As senior officers of Valeant, these individuals' scienter is imputed to the Company.

When testifying before the Senate Committee on Aging regarding price spikes in the pharmaceutical industry, Pearson admitted that the Company had "made mistakes" and that price was more responsible for growth than volume, which contradicted many previous declarations by Pearson that volume had equal or greater influence on growth than price. Similarly, in testimony before the Congressional House Oversight Committee, Schiller also acknowledged that the Company "made a lot of mistakes" with regards to pricing and would not be pursuing similar strategies moving forward. Also in connection with

Congressional probes, Philidor was asked why Valeant did not simply purchase Philidor outright rather than acquire the option to purchase it for $0. Philidor's counsel, in a written response, said that "Philidor concluded that Valeant's conduct was consistent with a concern about the economic impacts of any PBM [pharmacy benefit manager] response if Valeant had purchased Philidor." Thus, Philidor confirmed Valeant knew PBMs would refuse to reimburse Philidor prescriptions if PBMs knew of the controlling relationship.

Valeant's failure to pursue remedies against Pearson, Schiller, Philidor, and Philidor executives is further evidence that the deceptive business practices were known and approved at the highest levels of the Company. Valeant, therefore, could not pursue remedies such as a clawback policy instituted in 2014 and an indemnification clause in its purchase option agreement with Philidor, for the very wrongdoing it condoned. Accordingly, the Company was limited to terminating the employment of its high-level executives responsible for the wrongdoing and winding down Philidor, without seeking recompense.

What's more, on August 12, 2016, it was reported that that the Company is under ***criminal investigation*** by the U.S. Department of Justice. According to the *Wall Street Journal*, federal prosecutors in the U.S. Attorney's Manhattan Office are investigating mail and wire fraud violations based on whether Valeant "defrauded insurers by shrouding its ties to a mail-order pharmacy [Philidor] that boosted sales of its drugs," and for deceptive business practices used to sell Valeant drugs, such as rebates and other compensation provided to patients. On October 31, 2016, it was further reported that Valeant's former CEO, Defendant Pearson, and the Company's former CFO, Defendant Schiller, are the focus of a U.S. criminal probe looking into potential accounting fraud charges related to Valeant's concealed ties to Philidor. Moreover, on November 17, 2016, federal prosecutors in Manhattan filed criminal charges against former Valeant executive Gary Tanner and former Philidor Chief Executive Officer Andrew Davenport. The Justice Department's complaint alleges that Tanner and Davenport engaged in a multi-million dollar fraud and kickback scheme. The claims for wire fraud, money laundering, and conspiracy carry sentences of up to 20 years in prison. Federal authorities emphasized that these charges are the first charges brought in an ongoing investigation into Valeant.

Valeant's Dermatology Business is Critical to the Company's Core Operations

The fact that the Company's dermatology business is critical to Valeant's core operations is further evidence of Defendants' knowledge of the Company's reliance on specialty pharmacies to drive sales growth. Notably, in ruling on the motion to dismiss, Judge Shipp found a strong inference of scienter *without even addressing* the "Core Operations Doctrine," thus demonstrating the strength of investors' claims. *In re Valeant*, 2017 WL 1658822, at *11, n.15.

In the Third Circuit, when defendants are senior managers and a fraud is alleged to have been committed within the company's core business, it is reasonable to infer that they did, in fact, know the facts surrounding key business matters relating to the "core operations" of the company. *See, e.g., W. Palm*

Beach Police Pension Fund v. DFC Global Corp., 2015 WL 3755218, at *16 (E.D. Pa. June 16, 2015) ("The fact that the allegations of fraud relate to Defendants' core business supports such an inference [of scienter]."); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d 574, 599 (D.N.J. 2001) (denying motion to dismiss, in part, because the plaintiff successfully pled that facts critical to the business's core operations were so important they could be attributed to key officers). As set forth above, Defendant Pearson recently stated that Valeant's dermatology business alone is responsible for $1.9 billion a year in revenue. By comparison, Valeant's total revenue for 2014 was about $8.2 billion, meaning that Valeant's dermatology segment alone is responsible for nearly 25% of the Company's annual revenues. Given the significant rate at which Valeant's dermatology drugs have grown, the Company's dermatology segment has had an outsized impact on the Company's total organic growth. Accordingly, the growth and sustainability of those revenues are central to the Company's core operations. In August 2016, the Company blamed its drop in revenue in its 2Q16 financial results on the slow recovery in its dermatology division, clearly indicating that Philidor's closing substantially affected Valeant's business performance.

Executive Departures and Government Investigations are Indicative of Scienter

Finally, we believe that these known or recklessly disregarded issues led to the terminations of Defendant Pearson, Valeant's CEO, and the resignation of Defendant Schiller, Valeant's CFO, which further strengthens the position that the problems were orchestrated from the highest levels of the Company. *See W. Palm Beach Police Pension Fund*, 2015 WL 3755218, at *17 (E.D. Pa. June 10, 2015) ("[W]hen considering the totality of Plaintiffs' scienter allegations, the Court concludes that the resignation of key executives . . . bolsters the evidence of conscious or reckless behavior."). The timing of these executive-level departures, in the wake of multiple internal and external investigations, is compelling. *See Pennsylvania Transp. Auth. v. Orrstown Fin. Servs., Inc.*, 2016 WL 466958, at *5 (M.D. Pa. Feb. 8, 2016) (a "resignation can strengthen an inference of scienter when it occurs around the same time as an investigation") (quoting *Thorpe v. Walter Inv. Mgmt., Corp.*, 2015 WL 4063932 (S.D. Fla. June 30, 2015)). Indeed, unlike most securities fraud cases, here Valeant's board has *publicly blamed* the Company's accounting errors on the "improper conduct" of Schiller, the former CFO, and the unethical "tone at the top" set by Schiller and Pearson, the former CEO. Of course, Pearson was responsible for Valeant's growth-by-acquisitions strategy, which ultimately led to the Company's downfall beginning last Fall in connection with the Philidor scandal and reports of larger issues involving the Company's sales, distribution, and accounting practices. Finally, the showing of scienter is bolstered by the multiple ongoing investigations of the Company by government regulators in the United States and internationally. As the Company has disclosed in its SEC filings, Valeant is currently the subject of investigations by the SEC, U.S. Attorney's Offices in Massachusetts and New York, the state of Texas, the State of North Carolina Department of Justice, and the Senate's Special Committee on Aging and the House's Committee on Oversight and Reform. Additionally, Valeant has received document demands from the Autorite de Marches Financiers in Canada and the New Jersey State Bureau of Securities.

* * *

Taken as a whole, we believe that the facts already adduced to date, as well as the facts developed in discovery, will amply establish Defendants' scienter and that investors will be able to prevail on their claims. Judge Shipp has already found that the "totality" of Plaintiffs' allegations and a "holistic" reading of the Complaint give rise to a strong inference of scienter.

(iii) Loss Causation

In addition to establishing material misstatements or omissions of fact and scienter, plaintiffs must also demonstrate loss causation, which "requires a plaintiff to show that a misrepresentation that affected the integrity of the market price ***also*** caused a subsequent economic loss." *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) (emphasis in original). It is not enough that a plaintiff may have bought stock at an inflated price in reliance on misrepresentations or omissions; rather, establishing loss for securities fraud requires that the share value depreciated as a result of the disclosure of information that was misrepresented or concealed. *See Dura,* 544 U.S. at 344. To satisfy the loss causation requirement in the Third Circuit, "the plaintiff must show that the revelation of that misrepresentation or omission was a substantial factor in causing a decline in the security's price, thus creating an actual economic loss for the plaintiff." *In re Merck & Co., Inc. Sec., Deriv. & "ERISA" Litig.*, 2011 WL 3444199, at *29 (D.N.J. Aug. 8, 2011) (citation omitted).

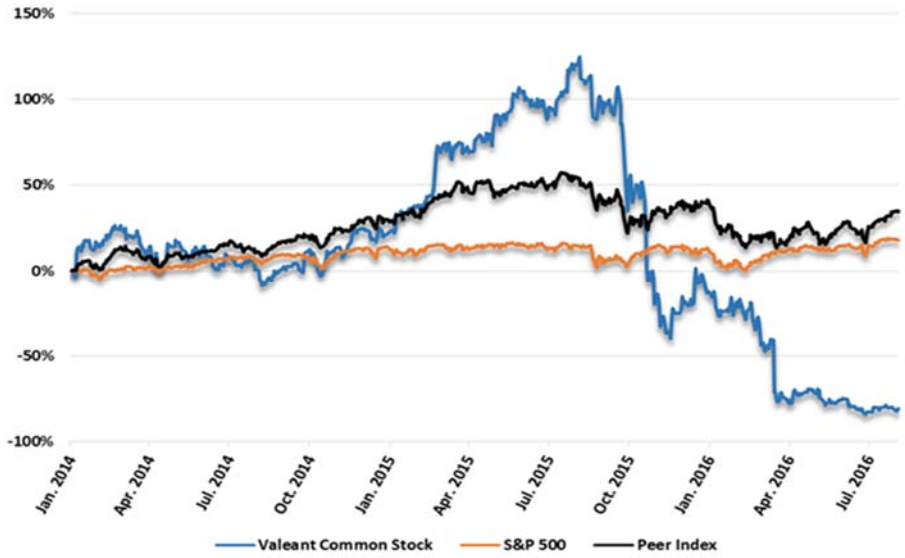
Here, specific disclosures relating to Valeant's practice of substantially increasing the price of its drugs and direct financial interest and reliance on a network of captive specialty pharmacies caused the price of Valeant shares to decline substantially by the end of the Relevant Period. Investors will argue, with the support of a financial expert, that all of the individual declines in the stock price were caused by disclosures of information specific to the Company, as opposed to industry-wide trends or developments. These disclosures, and the resulting decline in the price of Valeant stock, were the result of foreseeable concealed risks materializing with the disclosure that the Company's growth was mostly, if not completely, dependent on its unconventional, and potentially illegal, distribution strategy. Defendants have attempted to minimize the compensable damages in the litigation by arguing that the corrective disclosures identified by the Class Action plaintiffs, or certain of the disclosures, did not actually reveal new information, but merely commented on previously disclosed facts.

For example, the Defendants will likely continue to argue that the disclosures identified by plaintiffs from September 28 to October 15, 2015, did not provide new information or correct a previous misstatement. Defendants have pointed to articles about the high prices of two Valeant drugs published before the start of the Relevant Period as evidence that the Company's price gouging had already been revealed, and have argued further that the risks were otherwise revealed by Allergan during a 2014 proxy fight. However, Defendants' argument ignores the dramatic drop in the price of Valeant shares in response to the information revealed at the start of the Relevant Period, which included the revelation that members of Congress were calling for Valeant to be subpoenaed and investigated. In addition, the other articles cited by Defendants reported problems across the pharmaceutical industry as well as Valeant, which Defendants

conceded. In contrast, the articles cited by investors specifically concern Valeant and its practices. Further, the proxy fight which Defendants claim revealed Valeant's business risks has been described by Defendants as a "misleading" attempt by Allergan to lower Valeant's stock price, discrediting Defendants' own argument. Indeed, Defendants' loss causation arguments completely failed at the motion to dismiss stage, as Judge Shipp refused to shorten the Class Period or eliminate any of the alleged partial corrective disclosures. *In re Valeant Sec. Litig.*, 2017 WL 1658822 at *12.

Next, Defendants will likely continue to argue that the fraud as it related to Philidor and the resulting financial consequences was fully disclosed as of October 30, 2015. However, this ignores the fact that after such date, Valeant was required to restate certain of the Company's financial statements, admit that the Company lacked proper internal financial and disclosure controls, lower its revenue and earnings guidance, and reveal a previously undisclosed SEC investigation that included a subpoena received during 4Q 2015. Further, analysts, news outlets, and Valeant itself continued disclosing to the market the true extent to which Valeant's business model was reliant upon its fraudulent scheme well into 2016. Each of these successive disclosures continued to reduce Valeant's remaining market value. Perhaps most damning of all disclosures occurring after October 30, 2015, is the revelation that Ackman had requested that Valeant management "come clean," regarding Philidor and "expressed his disspointment that Valeant did not do so." Such facts demonstrate that the entirety of the fraud and its potential financial impact were not revealed to the market until after October 2015, a conclusion that the Court accepted at the pleading stage.

Further, while Defendants will likely continue to argue that other factors caused the price of Valeant stock to decline (e.g., criticism of the pharmaceutical industry at large), we believe that investors will be able to convincingly show that significant price declines were, in fact, attributable to the fraud. Comparing Valeant's stock performance to those of the Company's peers over the Relevant Period shows that Valeant's decline was an abberation in comparison to its peers and the market at large. Accordingly, industry-wide factors—such as widespread criticism of the pharmaceutical industry—that would apply equally to the Company's peers cannot be the sole explanation for the decline in price of Valeant stock. The below graph illustrates this very point, with Valeant stock—indicated as the blue line below—declining to a significantly greater extent as compared to the S&P 500 (orange) and an index of Valeant's principal competitors (black):



Moreover, as discussed above, based on our ongoing work with outside forensic experts, we believe investors will be able to successfully establish that numerous disclosures concerning the fraud led to statistically significant stock declines that resulted in harm to investors, and are thus compensable as damages under the federal securities laws.

(3) Strict Liability Claims Under Section 18 of the Exchange Act

The SBA may also be able to pursue recovery under Section 18 of the Exchange Act. Section 18 creates a private right of action against defendants who make, or cause to be made, materially misleading statements in documents or reports filed under the Exchange Act, unless the defendant can prove that he or she acted in good faith and without knowledge of the statement's falsity. 15 U.S.C. § 78r(a); *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 283 (3d Cir. 2006). Section 18 claims are particularly powerful because they do not require plaintiffs to demonstrate that defendants acted with scienter. As the courts have observed, "[a] plaintiff seeking recovery under [Section] 18 faces a significantly lighter burden" than a plaintiff seeking recovery under Section 10(b). *Ross v. A.H. Robins Co.*, 607 F.2d 545, 556 (2d Cir. 1979); *accord Suprema*, 438 F.3d at 283 ("A section 18 plaintiff ... bears no burden of proving that the defendant acted with scienter or any particular state of mind."). "Instead, the burden of proving state of mind falls upon the defendant, who must demonstrate good faith and lack of knowledge that the statement on the filing was false or misleading." *In re Able Labs. Sec. Litig.*, 2008 WL 1967509, at *25 (D.N.J. Mar. 24, 2008).

Section 18 claims typically cannot be brought through a class action, and the Consolidated Class Action Complaint against Valeant does not assert such a claim. This is because Section 18 claims require investors to make an individualized showing—which generally cannot be made on a class-wide basis—that they read and relied on the documents containing the false statements in making their investment decisions. See *In*

re Able Labs., 2008 WL 1967509, at *26 (upholding sufficiency of Section 18 reliance allegations where plaintiff alleged the "specific statements made on a specific form that was filed with the SEC" and "pleads that the statements were read and relied upon in connection with the purchase of Able securities"). Here, given the importance to investors of Valeant's business and growth plans, as well as its reported revenues, there is a strong likelihood that the SBA's relevant investment teams reviewed and relied on the subject material misstatements included in Valeant's annual and quarterly reports when making their investment decisions if they followed fundamental, research-based investment strategies.

Importantly, there are timeliness concerns surrounding Section 18 claims. The statute of limitations for asserting Section 18 claims has already expired under relevant district court decisions in the Third Circuit (including the District of New Jersey), which hold that Section 18 claims are subject to a 1-year statute of limitations. Significantly, however, the Third Circuit has not decided the issue, and the only federal circuits to have addressed the issue – namely, the Second Circuit and the Fifth Circuit – hold that Section 18 claims are subject to a longer 2-year statute of limitations for "fraud" claims contained in Section 804 of the Sarbanes-Oxley Act, codified at 28 U.S.C. § 1658(b). *See, e.g*., *Dekalb Cty. Pension Fund v. Transocean Ltd.*, 817 F.3d 393, 405-08 (2d Cir. 2016) ("[T]hese factors lead us to join the Fifth Circuit in concluding that . . . Section 18(a) is governed by § 1658(b)."). Judge Shipp has not yet ruled on the issue. If Judge Shipp adopts the Second Circuit and Fifth Circuit's view, Section 18 claims for all of the SBA investments in Valeant securities remain timely if asserted in a direct action – and only in a direct action.

(4) "Control Person" Claims Under Section 20(a) of the Exchange Act

Section 20(a) of the Exchange Act provides a cause of action against a person who controlled someone who violated another section of the Exchange Act. To establish control person liability, a plaintiff must show: (1) the defendant controlled another person or entity; (2) the controlled person or entity committed a primary violation of the securities laws; and (3) the defendant was a culpable participant in the fraud. *In re Suprema,* 438 F.3d at 286. "Culpable participation refers to either knowing and substantial participation in the wrongdoing or inaction with the intent to further the fraud or prevent its discovery." *In re Merck & Co., Inc. Sec., Deriv. & "ERISA" Litig.*, 2012 WL 3779309, at *9 (D.N.J. Aug. 29, 2012). Because Section 20(a) liability largely turns on the success of the primary violation under Section 10(b), control person claims would likely be successful once primary Exchange Act violations are established.

Defendants Pearson, Howard Schiller, and Robert Rosiello (the "Individual Defendants"), as executives of the Company, were control persons of Valeant. As set forth above, Valeant violated Section 10(b) of the Exchange Act by making false and misleading statements and omissions regarding its deceptive practices. The Individual Defendants were active participants in Valeant's scheme or did nothing to stop it. Accordingly, we believe that control liability claims against the Individual Defendants will be successful. Indeed, in denying Defendants' motions to dismiss the class plaintiffs' Section 20(a) claims, Judge Shipp noted that Defendants' ***only*** argument supporting dismissal of the control person claims hinged on finding that the primary violation did not occur. *In re Valeant Sec. Litig.*, 2017 WL 1658822, at *12-13.

(5) State Law Claims

As noted above, claims for recovery of losses incurred on shares purchased on the Toronto Stock Exchange are not recoverable under the federal securities laws. *See Morrison v. National Australia Bank* Ltd., 561 U.S. 247 (2010). However, in certain situations, courts have permitted plaintiffs in ***individual actions*** – in particular, state pension funds – to pursue recovery of losses incurred on non-U.S. stock exchanges under state law. Here, the potentially available state law claims include common law fraud, fraud in the inducement, and negligent misrepresentation. *See, e.g.*, *Tucker v. Mariani,* 655 So. 2d 221, 224 (Fla. Dist. Ct. App. 1995) (investor presented jury question as to whether officers of corporation had engaged in common law fraud). The elements of each of these claims substantially overlap with the elements of a federal securities fraud claim, yet there is no prohibition on seeking recovery for losses incurred on a foreign stock exchange. For example, the element of a claim for Florida common law fraud are: (1) a false statement concerning a material fact; (2) knowledge by the speaker that the representation is false; (3) an intent by the speaker to induce the plaintiff to act on the statement; and (4) detrimental reliance by the plaintiff. *Id.* (citing *Lance v. Wade*, 457 So.2d 1008, 1011 (Fla. 1984)). Accordingly, we believe the SBA has meritorious common law claims to pursue damages incurred on Valeant U.S.-listed shares and Canadian-listed shares.

Impact on Investments that the SBA May Have in Valeant and Other Beneficial or Adverse Consequences to the SBA

The filing and resolution of the SBA's direct action claims should have **no** adverse impact on any investments that the SBA may have in Valeant. In contrast, an affirmative litigation strategy may provide important benefits to the SBA and our health care system.

First, based on the most recent transactional data supplied to the Firm on July 12, 2017, the SBA ***has completely liquidated its position in Valeant's U.S. shares***.

Second, as to Valeant's Canadian shares, the SBA has similarly liquidated the vast majority of its position. Based on the most recent transactional data supplied to the Firm, the value of these retained Canadian shares is only $2.8 million.[2] This represents a tiny fraction of the SBA's original investment in the Company, a tiny fraction of the SBA's potential damages claim, and a tiny fraction of Valeant's market capitalization.

Third, even if the SBA were to litigate its potential $62 - $65 million direct action claims to a successful verdict, we believe Valeant would have ample assets to fund a substantial settlement or judgment without materially impacting the value of the SBA's current $2.8 million value investment in the Company. As

[2] Based on the transactional data supplied to the Firm on July 12, 2017, the SBA held 167,778 Canadian shares as of July 11, 2017. Assuming the SBA continues to hold these shares, their current value is approximately $2.8 million based on the July 18, 2017 closing price. Valeant's last U.S. shares were sold over seven months ago, on December 15, 2016.

discussed below, we believe that Valeant maintains a sufficient D&O liability insurance program that significantly exceeds the SBA's damages claims. This would be the first asset to which Defendants would look to fund any settlement or judgment of the SBA's claims, and its use would have no adverse impact on the Company's balance sheet or the SBA's current investment (if any) in Valeant. In the event the Company's D&O insurance program is insufficient to fund the entire direct action settlement or judgment, the Company recently reported over $1.2 billion dollars of cash (and billions of dollars of other assets) to cover any deficit without materially impacting the SBA's current investments in the Company. Finally, the Individual Defendants—who bear personal responsibility for the serious and knowing misconduct here at issue—also have significant assets to fund the resolution of the SBA's claims, and their personal contributions would have no impact on the SBA's current investments in Valeant.

Finally, the SBA's pursuit of its Valeant direct action claims could provide important, corporate governance and other benefits to the Company, and our nation's health care system. We believe the action against Valeant presents a compelling opportunity for the SBA to not only obtain a substantial monetary recovery, but to enact important corporate governance reforms at a company that not only orchestrated a pervasive accounting fraud, but also cultivated a business model reliant upon incessant and unsustainable price gouging of necessary medications. We outline in **Exhibit B** several draft proposals that address some of the most obvious failings at the Company—including deficiencies with respect to:

- Financial statement disclosures and controls;
- A lack of transparency with shareholders; and
- A willingness to engage in short-term, unsustainable business practices.

We address in **Exhibit B** each of these areas of concern not only in the context of Valeant, but also how these issues infect an industry that has consistently put tremendous strain on the nation's healthcare system—particularly the insurers and third-party payers who incur the lion's share of healthcare costs—in the interest of short-term profits. By taking an active role in the Valeant action, the SBA would have an opportunity to implement meaningful corporate governance reforms at a prominent pharmaceutical company in an industry that has shown disturbing reluctance to develop a long-term and sustainable approach to pharmaceutical development and sales, as well as the healthcare industry at large. By serving as a named plaintiff in the litigation with a substantial damages claim, the SBA would have a unique and powerful voice to demand meaningful changes in the industry.

Valeant's Current Financial Condition and Ability to Pay a Substantial Settlement or Judgment

We do not believe there are any debt service issues or ability to pay issues adversely affecting an SBA opt out.

Valeant's new management, led by CEO Joseph Papa under the oversight of an expanded and overhauled Board of Directors, has publicly committed to reducing Valeant's debt. Valeant's debt load currently stands at approximately $27 billion. Since the first quarter of 2016, Valeant has reduced its debt by more than $4.3 billion. On July 10, 2017, Valeant reiterated that it expects to pay down an additional $5 billion in debt by February 2018 from divestiture proceeds and free cash flow, and confirmed that all mandatory amortization has been paid through 2019. In addition, Valeant's management has successfully renegotiated the maturity dates on certain of its debt obligations, and, based on its current and projected free cash flow (discussed below), the Company should not have difficulty handling any debt principals that come due that cannot be refinanced. Looking forward, Valeant still has major non-core assets to sell, such as Bausch & Lomb, and no major near-term debt maturities until 2021, when a manageable $3 billion worth of bonds come due.

The Company's recent financial performance has also been positive. The Company reported over $42 billion in assets as of March 31, 2017, including $1.2 billion in cash, more than double what it reported just one year prior. The Company's first quarter 2017 free cash flow totaled $785 million, and its operating cash flow was an even healthier $954 million. Because of its recent performance, including an upward revision to the Company's EBITDA outlook by approximately $500 million, there was a massive short-squeeze. Valeant's stock price has almost doubled in price over the last four months, from less than $9 in April to its current price near $17. The recent surge and short squeeze reflects a favorable sentiment shared by many analysts and institutional investors regarding the Company's long term prospects.

Accordingly, we continue to believe that Valeant has sufficient funds to satisfy both a substantial judgment or settlement of the opt outs, and a sizeable class action settlement. Valeant's ability to pay should only get better as its turnaround advances and its financial health continues to improve. In addition, we understand that Valeant maintains a substantial D&O liability insurance program, which easily exceeds the SBA's maximum damages and should be available to fund both class and opt out settlements. Notably, the conventional wisdom that opt out recoveries only occur after class action settlements has been undercut in recent cases. For example, in the Petrobras securities litigation, the company has already reached opt out settlements totaling $445 million – including with such major institutional investors as Vanguard, Janus, Dodge & Cox, PIMCO, New York City Employees Retirement System, Ohio Public Employees Retirement System, Washington State Investment Board, and the State of Alaska Department of Revenue – even though the class case and other major opt out cases remain pending. Here too, there may be opportunities for the opt outs to resolve ahead of the class case.

Finally, we do not believe the pending DOJ or SEC investigation will have any material impact on investors' recovery. Historically, Government investigations and enforcement actions have resulted in relatively *de minimus* financial consequences to defendants and recoveries for investors. By way of example, BLB&G has recovered over $6.5 billion for investors in financial-crisis era cases whereas the SEC has recovered little to nothing in such cases.

Other Institutional Investors Represented by BLB&G In This Matter

BLB&G is privileged to represent a number prominent institutional investors pursuing direct actions against Valeant. The Firm's pending Direct Actions include major mutual funds, pensions funds and 401K plans, hedge funds, insurance companies, and other institutional investment managers:

- T. Rowe Price
- Teacher Retirement System of Texas
- Principal Financial
- Voya Financial
- Foreign & Colonial
- Jackson National
- Penn Series Funds
- BloombergSen
- ConAgra
- Dow Corning
- Milliken Co.
- Minnesota Life Insurance Co.
- Securian Funds
- Alleghany Corp.
- City of Tallahassee Pension Plan
- Capitol Indemnity Corp.
- Capitol Specialty Insurance Corp.
- Specialty Insurance Corp.
- Pacific Compensation Insurance Co.
- Platte River Insurance Co.
- RSUI Indemnity Co.
- Transatlantic Reinsurance Co.

See T. Rowe Price Growth Stock Fund, Inc. et al. v. Valeant Pharms. Int'l, Inc. et al., No. 16-cv-05034 (D.N.J.); *Equity Trustees Ltd.. et al. v. Valeant Pharms. Int'l, Inc. et al.*, No. 16-cv-06127 (D.N.J.); *Principal Funds, Inc. et al. v. Valeant Pharms. Int'l, Inc. et al.*, No. 16-cv-06128 (D.N.J.); *Bloombergsen Partners Fund LP. et al. v. Valeant Pharms. Int'l, Inc. et al.*, No. 16-cv-07212 (D.N.J.). As discussed above, we recommend that the SBA file a direct action complaint, in the same court as our pending Direct Actions, that is substantially similar to the comprehensive complaints already on file in the pending Direct Actions. This should allow the SBA to avoid unnecessary risk, duplicative motion practice, and delay; benefit from favorable rulings in the Direct Actions and the Class Action; and join the pending litigations at or approaching a relatively advanced stage.

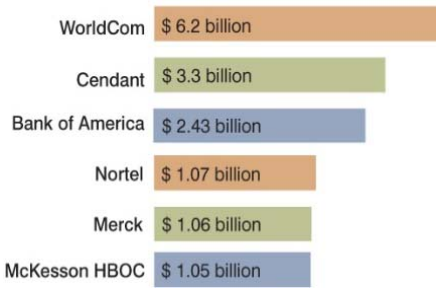
We firmly believe that by banding together with other prominent institutional investors with significant losses and experience in opt out cases, the SBA will enhance its ability to maximize its recovery of damages. For example, as the SBA is aware, BLB&G represented the largest and most prominent opt out group in the *Countrywide* matter and successfully resolved our clients' direct action claims within months of filing a complaint. We promptly distributed the BLB&G opt out recovery to our opt out clients, including the SBA, within weeks of reaching an agreement in principle to settle the claims, and long before other opt outs and the class received any recovery. Likewise, in our *Tyco* direct action, BLB&G recovered and promptly distributed over $105 million for prominent institutional investors, which represented nearly 10x the class action recovery. Finally, in our Marsh & McLennan direct action, we confidentially recovered and promptly distributed to a group of prominent institutional investors a substantial multiplier over the class recovery.

Conclusion

By selectively recommending that specified investors opt out of certain securities class actions, BLB&G has built a demonstrated track record and reputation of resolving our clients' claims efficiently and for substantial multiples of available class action recoveries. Based on our research, investigation and experience, the SBA has strong direct claims against Valeant and we recommend that the SBA pursue direct resolution of their claims as part of the group of prominent institutional investors represented by BLB&G. We believe this is an excellent opportunity for the SBA to receive a substantial premium over any recovery it may receive as passive participants in the Valeant securities Class Action. We are happy to answer any additional questions you may have about this unique opportunity.

About BLB&G

BLB&G is one of the leading law firms worldwide advising public pension funds and institutional investors on securities litigation, corporate governance and shareholder rights issues. Unique among firms specializing in the representation of institutional investors, we have obtained many of largest securities recoveries in history - more than any other firm - and nearly $31 billion on behalf of investors since our founding in 1983. Working with our institutional clients, our cases have resulted in sweeping corporate governance reforms, changing deficient business practices and serving as models for public companies.



BLB&G is widely recognized by industry observers for its legal excellence and achievements, and is credited for "consistently achieving the highest returns for investors" (*The National Law Journal*) among law firms prosecuting complex securities fraud. *Chambers USA*, in which clients declared that BLB&G "gives the best advice in the field," has awarded the firm its top ranking in plaintiff securities litigation every year since the category's inception. *Legal 500 USA* also ranks BLB&G among the top litigation firms every year, commending BLB&G for its "excellent reputation for robust representation in the field." In addition, BLB&G was named "Plaintiff Firm of the Year" by *Benchmark Litigation*, and is one of the only plaintiff-side firms to come "highly recommended" by the guide for its "impressive achievements and excellent reputation.

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SBA FLORIDA
STATE BOARD OF ADMINISTRATION

Investment Advisory Council
Compensation Subcommittee Conference Call
September 18, 2017

Agenda
Investment Advisory Council (IAC) Compensation Subcommittee Conference Call

Monday, September 18, 2017, 3:30 P.M.
Hermitage Room, First Floor
1801 Hermitage Blvd., Tallahassee, FL 32308

1.	**Welcome/Call to Order/Approval of Minutes of September 7, 2016 Meeting (Attachment 1A and 1B)**	Michael Price, Chair
2.	**Opening Remarks**	Michael Price, Chair
	Opening Remarks	Ash Williams, Executive Director & CIO
3.	**Recap of ED/CIO's FY 2016-17 Incentive Plan Design (Attachment 2)**	Jon Mason, Mercer
4.	**Presentation of Results of ED/CIO's Evaluation and Mercer's Salary Recommendation (Attachments 3A, 3B, Appendix to 3B, 3C)**	Jon Mason, Mercer
5.	**Discussion of Evaluation Results and Salary Recommendation by Subcommittee**	Michael Price, Chair
6.	**Formulation of Recommendation to IAC and Trustees**	Michael Price, Chair
7.	**ACTION REQUESTED: Approval of Recommendation**	
8.	**Other Business/Audience Comments/Closing Remarks Adjournment (Attachment 4, Information Only)**	Michael Price, Chair

Attachment 1A

MINUTES
INVESTMENT ADVISORY COUNCIL
COMPENSATION SUBCOMMITTEE CONFERENCE CALL
September 7, 2016

A special meeting of the Investment Advisory Council (IAC) Compensation Subcommittee was held on Wednesday, September 7, 2016, in the Hermitage Room of the State Board of Administration of Florida (SBA), Tallahassee, Florida. The attached transcript of the September 7, 2016 meeting is hereby incorporated into these minutes.

IAC Compensation Subcommittee Members Present:	Michael Price, Chair (Via telephone) Peter Collins (Via telephone) Les Daniels (Via telephone) Vinny Olmstead (Via telephone) Gary Wendt (Via telephone)
Other IAC Members Present:	Chuck Cobb (Via telephone) Bobby Jones (Via telephone)
SBA Employees:	Ash Williams, Executive Director/CIO Lamar Taylor Kathy Whitehead Randy Harrison
Consultant:	Josh Wilson, Mercer (Via telephone)

WELCOME/CALL TO ORDER/APPROVAL OF MINUTES OF APRIL 21, 2016 MEETING

Mr. Michael Price, Chair, called the meeting to order at 2:00 PM and asked Mr. Ash Williams, Executive Director & Chief Investment Officer (EDCIO) to detail the purpose of the meeting. Mr. Williams explained that the purpose of the meeting was to discuss the EDCIO's incentive compensation package evaluation results and recommendation for the Trustees and then to vote on that recommendation.

OPENING REMARKS

Mr. Williams summarized the Incentive Plan evaluation process for the EDCIO. He explained that the subjective component of the total incentive compensation (15 percent) was what the IAC Compensation Subcommittee would be considering during the conference call.

Mr. Williams asked Mr. Josh Wilson, Mercer, to provide specific details of the SBA's incentive plan, including the number of participants, information on the incentive target, and the total cost.

There was a brief discussion about the incentive compensation results for other SBA staff members based on performance levels as well as other criteria. Mr. Lamar Taylor, Deputy Executive Director, indicated that the information on asset class performance was not ready at that time but that SBA staff would get the information to the IAC members when it was available.

Mr. Williams clarified that some investment valuations (e.g., real estate) are done only once a year due to the time and cost involved, and had not been completed at that time.

RECAP OF EDCIO'S FY2015-16 INCENTIVE PLAN DESIGN

Mr. Wilson directed the IAC members to attachment 2A, the Incentive Plan Design for the EDCIO for Fiscal Year 2015-16, and explained the organizational (quantitative) and individual (qualitative) components of the plan.

PRESENTATION OF RESULTS OF EDCIO'S EVALUATION

Mr. Wilson presented the results of the Subcommittee members' Qualitative Evaluations for the EDCIO in the following categories: overall mission; people; efficiencies/infrastructure/operations; interactions with the IAC, PLGAC and Audit Committee; and overall individual/qualitative performance rating.

DISCUSSION OF EVALUATION RESULTS BY SUBCOMMITTEE

Mr. Williams and Mr. Wilson answered questions from IAC members about the quantitative payout and the individual component of the Incentive Plan for the EDCIO.

Mr. Williams presented the key points contained in his letter of July 15, 2016. He also answered questions about SBA performance versus peers in other state pension plans.

FORMULATION OF RECOMMENDATION TO IAC AND TRUSTEES

There was a discussion during which several IAC members expressed the opinion that the maximum individual/qualitative performance objective for the EDCIO had been met and that they would support a highest rating which, if the FRS Trust Fund's investment performance value added is 50 basis points or higher, would translate to a qualitative award of approximately $30,000.

ACTION REQUESTED: APPROVAL OF RECOMMENDATION

Mr. Bobby Jones recommended approval of the maximum individual qualitative incentive award for the EDCIO. Mr. Peter Collins seconded the motion. The motion to approve the recommendation passed unanimously.

AUDIENCE COMMENTS/CLOSING REMARKS/ADJOURNMENT

Mr. Williams, Mr. Wilson, and IAC members discussed the Incentive Compensation Plan design as it relates to other SBA employees and the percentage of those employees who may be eligible to receive the maximum incentive compensation.

Mr. Jones moved that the minutes from the April 21, 2016 IAC Compensation Subcommittee conference call be approved; Mr. Collins seconded the motion. The minutes were approved.

The meeting was adjourned at 2:55 PM.

Michael Price, Chair
IAC Compensation Subcommittee

11/17/16
Date

Attachment 1B

STATE BOARD OF ADMINISTRATION OF FLORIDA

INVESTMENT ADVISORY COUNCIL

COMPENSATION SUBCOMMITTEE

CONFERENCE CALL

WEDNESDAY, SEPTEMBER 7, 2016
2:00 P.M. - 2:55 P.M.

1801 HERMITAGE BOULEVARD
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TALLAHASSEE, FLORIDA

REPORTED BY: JO LANGSTON
Registered Professional Reporter

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APPEARANCES

IAC MEMBERS:

MICHAEL PRICE
LES DANIELS
GARY WENDT
PETER COLLINS
VINNY OLMSTEAD
BOBBY JONES
CHUCK COBB

SBA EMPLOYEES:

ASH WILLIAMS, EXECUTIVE DIRECTOR
LAMAR TAYLOR
KATHY WHITEHEAD
RANDY HARRISON

CONSULTANTS:

JOSH WILSON - (Mercer)

INVESTMENT ADVISORY COUNCIL
COMPENSATION SUBCOMMITTEE
CONFERENCE CALL

* * *

MR. PRICE: This meeting concerns -- it's a follow-on from last June -- it may be a follow-on from July's compensation subcommittee of the IAC to approve Ash's compensation package based on both input we get quantitatively and qualitatively and our own survey of Ash's performance. And it's fine that Ash is on as part of the call. So we're going to have a presentation.

And I think, Ash, you should make a comment first, and Josh Wilson from Mercer will have some comments. I would like to make a few comments at the end of Josh's, and then we can have a vote. I think everyone has received the package of contents, which included the Mercer work, as well as the July 15th letter from Ash, talking about his view of his role at the IAC since -- Ash, is it since '07 or '08?

MR. WILLIAMS: I got back in Q4 of '08.

MR. PRICE: '08. I think it's been a tremendous run. I think the IAC is doing better than ever. And that is based on my, you know, I think it's been three or four years' dealings with Ash but also with his staff, extensively with his staff on separate phone

calls with and without Ash, going over positions and approaches and all that. And I think the -- on the qualitative aspect side of it, I think he's got a good team. I've enjoyed working with them. And I just want to hand it over to Josh. Josh or Ash, if you want to interject now, either one of you, with some thoughts.

MR. WILLIAMS: Sure. Thank you, Michael. Really what we're doing today is following a process that's set forward in attachment 3A of today's materials, which wraps up the part of this process on the incentive that applies to the executive director and CIO. The reason we have that one-person focus at the level of the comp subcommittee of the IAC, of course, is that either I, for my direct reports, or other executives here at the board for their subordinates, can handle the qualitative element of their incentive comp.

The quantitative element, which is driven by investment performance, handles itself. But given that I'm at the top of the pyramid here, there's nobody to do that review for me, so that's the role that you folks are in. And the process we follow is that we start off with me submitting a self-assessment, which I did circa July 15. And that is then shared with you. Each of you responds with an evaluation of your own on

a set of criteria, share those with Josh. He then combines them, sends them back to me, and I share them with you, which is the tee up for today's meeting.

All of those things have happened. Josh will go over the results of his tabulation in just a second. But basically that's where we are.

And back in the spring of this year, when we adopted the budget of the SBA for fiscal 16-17, we included an increment of money to cover the second half of the incentive program, the first half of which we had already created funding for in fiscal 15-16. So we're fully positioned to move ahead. And it really is just a question of what everybody earns.

And the way it works, again, is we have varying components of total incentive comp, quantitatively driven by very explicit numerical accomplishments of relative performance. And the more senior one is and the more ability one has to influence investment outcomes, the higher the proportion of that quantitative determination of incentive comp is.

So in the case of the executive director and CIO, it's 85 percent of the total incentive comp. The subjective component is 15 percent, and it is that 15 percent that we're discussing today. So unless anyone has questions, I'll hand off there to Josh.

MR. WILSON: Thank you, Ash. Can everyone hear me okay?

MR. PRICE: Yes.

MR. WILSON: Terrific. Well, if you'll allow, what I'd love to do is just give you a 60-second recap of the plan itself and then dive into what we did and the results of what we did. So, if you remember, we approved an incentive plan for about 62 people that is primarily quantitatively driven. Between 75 and 90 percent of all participants' measurement is quantitative, based on the value add to the Florida Retirement System Trust. There is a target of 25 basis points outperformance, a threshold of 5 and a maximum of 50.

The incentive target by level varies from 10 percent of salary at the lowest level, with people like analysts or traders, up to a maximum target of 35 percent for the CIO. It is measured on three year performance. Whatever incentive is earned, half of it is paid at the end of the cycle. The other half is deferred one year, to help with retention of the individuals.

As I mentioned, the CIO has a target of 35 percent. At threshold there's a 17 and a half percent payout, and at maximum there's a 52 and a half

percent payout. Within those numbers is an 85/15 split. Eighty-five percent is based on the quantitative achievement of the total fund, and 15 percent is based on the qualitative assessment, which is what we're here to discuss today.

The last bit of information, just so you recall, the total cost of the plan for the 62 individuals at target was 1.4 million, and the cost for the CIO at target for the incentive plan was 134,000.

Any questions on that before we move specifically to -- I believe it's attachment 2A, which is the page describing the CIO specifically?

MR. WENDT: Are you going to discuss what the results for everyone other than the CIO have been? I don't mean each one. In total, how did it work out?

MR. WILSON: I'm not sure if that's answerable yet because the results are not audited. But, Ash, maybe you want to handle that.

MR. WILLIAMS: Yes. Where we are so far, Gary, on the performance is that the investment performance is -- and this is unaudited. We will have audited numbers probably Q4 of this year. But as of June 30, '16, the unaudited number is 71 basis points of outperformance, and that's a 61 basis point net return versus a benchmark of minus 11.

MR. WENDT: So what would that mean? If the audited comes out to be the same as the unaudited, which is highly probable, what percentage would people earn? And I know it varies depending on position, but give me above 2 percent, down 2 percent, whatever. Can you summarize?

MR. WILLIAMS: I think I can. I'm going to give you -- what we'll do is, assuming that the audited number comes out the way the unaudited one did, we would trigger the maximum quantitative incentive payout with any performance equal to or greater than 50 basis points. That would give the total cost of --

MR. WILSON: If I can, Ash. That results in the payment of approximately $2.1 million in aggregate, assuming that everyone's qualitative performance is equal to the quantitative, so they're both at max.

MR. WENDT: So everybody will max out on the quantitative part.

MR. WILLIAMS: Not necessarily, because there would be -- what that does is that's a triggering mechanism that creates funding. To the extent there has been any individual asset class that, for example, had underperformed in some meaningful way or had some other issue, a compliance issue or something like that, then they could get a significantly reduced or even no

incentive comp, depending on what's what, because the payment of that incentive comp is qualified not only by the quantitative performance but also by not having any compliance exceptions of a material nature, things of that nature. You have to be well behaved and have good scores.

MR. WENDT: But on the quantitative part, did anybody not get maximum?

MR. WILLIAMS: Again, we won't know yet until we have audited numbers but --

MR. WENDT: Given that audited equals unaudited. Okay. I won't get to talk to you about this again, so I've got to ask the question now. Is there anybody that isn't maxing out on the quantitative part of the performance test, assuming audited equals unaudited?

MR. TAYLOR: Honestly, Gary, we'll have to get back to you more specifically. These numbers that we have here are at the total fund performance level. And we don't have today ready, for even unaudited numbers, quotable for you today on asset class outperformance. It's possible that not everybody maxed out at the asset class level, and we'll just have to come back to you with that information.

MR. WENDT: I'd like to know that.

MR. TAYLOR: Okay.

MR. WILLIAMS: That's a completely reasonable request. And just to be clear, the reason why that delay is there is simply that some asset classes, primarily real estate, we do valuations once a year because the valuation process itself is time-consuming and expensive, and it really makes no sense to do it on a quarterly basis.

The other area where you'll see some lag will be in some of our private asset class holdings, notably private equity and some of the positions we hold in strategic investments.

MR. WENDT: Thank you.

MR. WILSON: Okay. If I can take you to the attachment 2A, you'll see it's a breakdown of the CIO's incentive design. You'll see that on the top line is a 35 percent opportunity. It shows how much is organizational, i.e., quantitative, how much is individual, or qualitative. So in the end, 15 percent of the total, or about five and a quarter percent of his target is qualitatively achieved. And from a dollar perspective, on a target of $136,000, 20,000 of that is the individual or qualitative section of it.

So with that, if I can take you to attachment -- I'm going to skip 3A because that's the process that Ash described. I'm going to take you to 3B, which is

our amalgamation really of the evaluations that everyone on the IAC subcommittee put together.

So on page one of that document, the document is called Qualitative Evaluation Review, et cetera. You'll see that all five members of the IAC compensation subcommittee submitted their evaluations in a number of different categories, the four that we're measuring, overall mission, people, efficiencies/infrastructure/operations, interactions, and then overall rating. We measured it using a zero through three scale. Three is exceeds expectations. Two is meets expectations. One is below, and zero is poor.

On the overall mission, of the five raters, four of them rated exceeds expectations and one rated meets expectations, and there were no comments. On the people, which is the following page, page three of the document, again, four people rated exceeds and one rated as a meets. And there were some comments there that I won't read for you at the bottom, but they are taken there verbatim.

On page four of the document, if you look at the efficiencies, infrastructure and operations, three of the five rated the CIO as an exceeds and two rated as meets, with no comments. On page five, the

interactions with the IAC, PLGAC and Audit Committee, again, three raters gave the CIO an exceeds, and two raters gave him a meets, with one comment there.

And finally, from an overall perspective, three raters gave the CIO an exceeds expectations and two raters gave him a meets expectations. And there's a comment at the bottom there and then some other commentary on page seven. Again, all the commentaries were taken verbatim from the evaluations.

MR. PRICE: Thank you, Josh.

MR. WILSON: Are there any questions from the committee on the process or how we did that?

MR. WENDT: Again, on the quantitative portion, assuming that audited equals unaudited, what will the bonus be or percentage of the maximum bonus be for the CIO?

MR. WILSON: If he maxes out on the both quantitative and qualitative, the maximum he can receive is 52 and a half percent of his salary. From a dollar perspective, I'll get that for you. From a dollar perspective, that's --

MR. WENDT: I understand the rules. I want to know now what happened, based on unaudited results, what percentage will be received of the 85 percent.

MR. WILLIAMS: If I understand -- this is Ash.

Gary, if I understand your question, your question is simply, if the numbers hold, what's the quantitative payout; is that right?

MR. WENDT: Yes, the percentage. If 85 percent is based on that and you've given us what the expectation, maximum and minimum is, given that those figures exist, what will the, with the unaudited result, what will the payout be?

MR. WILLIAMS: Yeah. What it would be would be, by my calculations, the organizational component or the quantitative component would be 44.65 percent. That translates into dollars of $173,814. And then the --

MR. WENDT: Can you say that one more time? Did you say that you would -- rather than 85 percent, you would get 62 percent of that 85 percent?

MR. WILLIAMS: If you look at the chart under exhibit 2A, it sets it all out quite clearly, in terms of the percentages, and also matches dollars to them. So what I did and what's broken down in the second half of that chart is the total incentive opportunity, the organizational component, which is also the quantitative investment performance piece, and then the individual component, which is the subjective piece we're talking about today.

And taking your question all the way through to

maturity, at maximum investment performance assumption, the total incentive opportunity would be 204,487, which is composed of two components. The quantitative piece is 173,814, and the individual component, or subjective component, would max out at 30,673.

MR. WENDT: I got all that. That was all in the presentation.

MR. WILLIAMS: Correct.

MR. WENDT: Now I want to know, based on the organizational component, which I think is quantitative, is it not?

MR. WILLIAMS: Yes, it is. That's right.

MR. WENDT: How did you do?

MR. WILLIAMS: Well, we think we're topping out, because what we're showing now is 71 basis points of outperformance. So 50 or above triggers the max. So we'd be maxed.

MR. WENDT: So you're going to get 173. Okay. That's all I wanted to know.

MR. WILLIAMS: Sorry if I made it complicated.

MR. OLMSTEAD: A quick clarification on the individual component, which it looked like they were pretty good scores, but I don't know how the individual qualitative review -- it may be in here -- turns into the individual at the 15 percent. So is there some

sort of numerical number in order to hit that, or in Gary's words, what's your estimate on the individual component?

MR. WILLIAMS: Right. And basically what you've got there -- and I'll defer to Josh on this. But what you've got is basically one of three options, one, two and three, which basically break you out at, just rounding out, as the chart shows on 2A, 10,000, 20,000, 30,000, depending on what your evaluations are.

Your evaluations clustered around exceeds, with a minority position of achieves in there. So what we're really not set up to do is extrapolate between the two. So I think whatever recommendation the group makes today it makes, and it's somewhere in that realm. It's either two or three, by my assessment.

MR. WILSON: If you just do the pure math -- this is Josh -- you have three threes and two twos. That's an average of about 2.6. So if you rounded it, it would round up. I think that's the committee's decision, whether it wants to go one, two or three on the qualitative component.

MR. PRICE: On that point, Ash, maybe you would like to go through some of the points in your letter.

MR. WILLIAMS: Yeah, sure.

MR. COLLINS: This is Peter Collins. I'm on. I

apologize for being late.

MR. WILLIAMS: Hey, Peter. Yeah. I mean, I think the key points in the letter -- I don't want to take you through it because it's in the book and I'm sure you've all had an opportunity to see it. But I think the key things that we've done are that we've gotten the overall mission right in terms of getting the team in place, keeping the governance environment together that makes good sense, working closely with the trustees to deal with all sorts of external constituencies, including the legislature, to achieve some very high level things, like getting the funding back on track for the fund after the great financial crisis and getting our performance and getting the teams right in all the various asset classes.

We've had fully 50 percent turnover in our management team over the nearly seven years that I've been back, including new heads in the majority of the asset classes; in fact, I'm just thinking out loud here, probably all the asset classes. And all of them have performed well. All of them have built good teams, and all of them have affected turnover as appropriate.

So I think not only have we done what we should have done, as indicated by a strong control environment

that gives us clean audit results, as indicated by investment performance that has generally exceeded not only our portfolio benchmarks but our long-term real return assumption, but we've also had a fair amount of external validation of what we've done.

And the external validation has come in several forms, not least of them being being recognized as the top large public pension fund in the country in 2015 by *Institutional Investor*. And I was pleased earlier this year to receive an award individually as the top large fund CIO in the United States from *Institutional Investor*.

And we've done a lot of things like that. Next week I'll be in New York. I'm on the advisory board of CNBC and *Institutional Investors*' Annual Delivering Alpha Conference. I'll be there for that. We're planning to be on Squawk Box that morning, talking about things that relate to what we do here. I think having a brand that has that kind of recognition nationally and internationally is good for the State and it's good for us and it helps us recruit and retain talent.

I think also the interaction we've had with you on the IAC, with your counterparts on the Participant Local Government Advisory Council and also our Audit

Committee, has been very constructive and open. And I think the change you'll see and the evolution in the way SBA and the role that we play and the job that we do as treated in the media has evolved very, very favorably over the past five years and is more or less where you'd like it to be.

There are always challenges. We're in a low return environment, and we will confront those with your help and do the best we can, and we're always open to new ways to do things and do them better.

MR. PRICE: Do any of the subcommittee people have any comments or questions of Ash?

MR. COLLINS: This is Peter Collins. I read the letter and actually had a conversation with Ash about it afterwards. I can't see -- I know we don't have a lot of experience at sort of perceiving these letters that the comp plan calls for, you know, for Ash to do these self-assessments. But I certainly thought it was thorough and covered all the aspects that we set out for him. I don't have any issues with the letter at all.

MR. COBB: Mr. Chairman, this is Chuck Cobb. I'm not on the committee, but I'd like to make a comment. First, I recognize --

MR. PRICE: Sure, go ahead.

MR. COBB: -- this is totally focused on the qualitative and not the quantitative things, and from my point of view, Ash and the team have exceeded what we might expect from a qualitative point of view. If I had a vote, I would vote max on the qualitative.

My question, which I think should be brought up as this committee deals with this important point, is the other quantitative issues. I actually lost in the voting, because I thought a portion of the incentive should relate to actual results and possibly peer review results. And I lost out on that vote. I was voted out, and we agreed that it would be totally based on performance vis-a-vis a benchmark and policy.

However, for this deliberation, I think it should be in the record, because I think it was pretty good, how we did on an absolute basis and how we did versus the other peers of state pension funds.

MR. PRICE: Thank you. So that should be noted in the --

MR. COBB: Ash, can you answer that question?

MR. WILLIAMS: Well, you know that we did well relative to our benchmarks. We've discussed that.

MR. COBB: I understand that.

MR. WILLIAMS: Relative to our peers broadly, there are several different ways you can cut that. But

I think by any measure we appear in the top half for most measurable periods. And then depending on whether you're looking at one, three, five, ten, 20, 25, et cetera, year periods, we will vary a little bit based on the following.

In periods where liquid equity markets do well, we will do better than our peers because we tend to have more global equity exposure and less alternative exposure than most of our large fund peers. In periods that are negative for public equity markets, they will sometimes outperform us by a little bit because they have less exposure to a bear market, even a transient bear market, and it will show up in a quarter or two.

MR. COBB: Ash, let me ask for a more precise -- for this year, as I understand it, we were positive, our funds were positive for the year being measured, and secondly we were in the top half of our peer review. Is that a correct assumption?

MR. WILLIAMS: That's correct. For the fiscal year ended June 30, from the range of reports we've seen -- and they're not all out yet, but for those we've seen with other major funds, we're pretty much middle of the pack or slightly ahead of middle of the pack. There are some that are a little better, some that are a little worse.

MR. COBB: And we were positive.

MR. WILLIAMS: Yes, sir.

MR. COBB: Positive by how much?

MR. WILLIAMS: A whopping 61 basis points net.

MR. COBB: No, no. Absolute.

MR. WILLIAMS: That is absolute. The relative performance was 71 basis points to the good.

MR. COBB: Because the benchmark was slightly negative, you're saying.

MR. WILLIAMS: Correct.

MR. COBB: And we were positive. Thank you, Mr. Chairman. I just thought it was important that be on the record, that although it's not part of our stated plan, some board members think it's important, and it clearly meets all the criteria that I had that we be positive and that we be doing well vis-a-vis our peers. So excuse me for interrupting.

MR. PRICE: Thank you very much, Chuck. Are there any other questions or comments from the members of the committee?

MR. JONES: Yeah. I don't know where we go from here, Michael, but it seems to me that based on our review of Ash's response, our understanding particularly of the organizational accomplishments this past year as set out in his performance objectives and

the fund's performance, it seems like the maximum individual objective has been met, and I think there's some subjectivity to that. But whether it's 26,000 or 30,000, I'm all for the 30,000 max, but it seems like that's what we're discussing.

MR. PRICE: Any other comments from committee members?

MR. WENDT: Gary Wendt has one. But it doesn't have to do with how much is the qualitative bonus to Ash. I'd like to just make sure somebody listens to me at the end.

MR. COLLINS: This is Peter Collins. I'm assuming that was Bobby Jones that was talking before Gary. And I would agree with Bobby on his recommendation. But, again, whether it's 26 or 30, I know relative to other state employees, that might be a big number, but I certainly think that if the 30 is the max, then I would vote for the 30.

MR. PRICE: Thank you. Are there any other comments from committee members?

MR. DANIELS: This is Les. I would go along with that.

MR. OLMSTEAD: Vinny Olmstead likewise.

MR. PRICE: Thank you, Les. Thank you. If I may speak, as I said at the outset, my interactions have

all been very positive with both Ash and the committee, and I feel very strongly that, you know, incentivizing people and compensating people is the right thing to do for the IAC, with Ash and his staff.

And as long as I'm sticking around, that's kind of where I come from. As I said before, a little turnover is good, but too much turnover is no good. And we certainly don't want any turnover in the leadership. And I feel very strongly that we vote for the recommendation of this incentive plan for our CIO.

MR. WENDT: Is it a recommendation?

MR. JONES: I recommend the maximum individual objective for the executive director and CIO, Ash Williams.

MR. PRICE: That's correct.

MR. COLLINS: If that was a motion, then Peter Collins will second it.

MR. PRICE: All in favor?

(Ayes)

MR. PRICE: Any opposed? The motion is passed to accept the recommendation. Thank you very much. Josh, thank you. Ash, thank you. And I think we'll be seeing everybody on the 19th.

MR. COLLINS: Gary Wendt had something to say, I think.

MR. WENDT: I do have a comment. And it has nothing to do with the -- I voted for the maximum. All that's good. But I think the answer to the first set of questions I was asking, which had to do with everybody other than Ash, was that we don't know but it's pretty sure everybody is going to get the max.

And whether or not that's 100 percent correct or 90 percent correct is less relevant than my thought that if we have a program which in a year where it's barely break-even and almost every (inaudible) we don't have a good plan, and that plan should be redesigned so that there are incentives to do better and not where people can max out, everybody can max out. It's just a comment.

MR. PRICE: Thank you, Gary. I understand. Any questions or comments?

MR. WILSON: Just one comment from Josh, if it's helpful. Just on a dollar basis, on the size of the fund that we're dealing with, $150 billion, 71 basis points of outperformance is about a billion dollars, and we're paying out about 2 million in incentive, which is less than .2 percent. The 99.98 percent, I believe, or 99.8 percent, is going back to the constituents. In the experience that I have with other states, that's a very, very good ratio and extremely

defensible.

MR. WENDT: I also think these people should be paid and paid a lot, and I wouldn't mind paying them more. My comments -- and I don't want them misinterpreted -- are directly at Marsh & McLennan here, I guess it is, who have designed a plan that we approved, which is not a good plan when almost everybody gets max. It's just not.

MR. WILLIAMS: Well, this is Ash, Gary. I hear all your points. I would just add, I don't think everybody will get max. Let's get there, and we'll have that conversation.

MR. COLLINS: This is Peter Collins. Gary, I can't disagree with you based on one premise. But on the other, I would disagree. So the one premise is, yeah, a comp plan that pays everybody 100 percent probably isn't great, because I can't believe that everybody deserves 100 percent.

But on the other hand, if we're tying it to performance, you can't really knock them for 71 basis points if that's outperformance. We don't want to be paying them to take too much risk to outperform the market. Right? So that's just not their role. Some of the managers, yes, but not on an overall basis.

So if the complaint is, hey, we've got a comp plan

that everybody got 100 percent, we probably need to look at that. If the complaint is they got 100 percent because -- you know, seeing as they only got 71 basis points, I don't have an issue with that.

MR. WENDT: I do. I do. And as a taxpayer --

MR. OLMSTEAD: What was the last two years? And just for maybe historical context, was it 100 percent in the last few years, or is this --

MR. WILLIAMS: The history, Vinny, on that, when we were doing the plan structure, when we looked back on this, with the thresholds that we set, the minimum trigger to pay any incentive comp of any kind would not have been met in 43 percent of the years in the history of the SBA, as I remember.

MR. COLLINS: So essentially what they're saying is, prior to us doing this, there really wasn't a real comp plan like you would traditionally think.

MR. WILLIAMS: Well, that's correct. But if you take a look at the thresholds that we've used in this plan and you applied them to the actual historical performance of the SBA, what I'm saying -- and, Josh, correct me if I'm wrong on this, but as I remember the analysis when we did the plan structure, at these thresholds, 43 percent of the time in the history of the SBA no incentive would have been triggered, zero.

MR. WENDT: Hey, look, if everybody thinks that a plan where almost everybody gets max is a good plan at a time when we're not even coming close to (inaudible) of what we're supposed to do for the pension, for the taxpayers, if everybody thinks that's fine, I'm not going to argue. But I've only been at this for 30 years, and I know that a plan where everybody goes home with a big smile on their face is not a good plan.

MR. OLMSTEAD: Ash, in the context of the last -- since you've been at the helm, what percentage do you think would -- you know, 43 percent over the history I get. How about what percent over your latest regime here?

MR. WILLIAMS: Over the -- go ahead, Gary.

MR. WENDT: Who did you ask that question to?

MR. OLMSTEAD: I'm just curious, from Ash's perspective -- and I understand over the history of the SBA, it's 43 percent. I'm just curious what it would be over the last seven or eight years.

MR. WILLIAMS: I don't know about the seven or eight, but over the six fiscal year-ends that I've been on deck since I came back, I think we would have triggered it every year.

MR. WENDT: Then your standards aren't -- then your objectives aren't high enough, if everybody wins

every year. What's the program for? You might as well put it in salary and let it --

MR. PRICE: Gary, this is Michael. I think it's a little different in the public realm, where the compensation is somewhat lower. I think it's a little different, number one. And, number two, I think there's something like 62 employees we're talking about in total. And not 100 percent of them are going to go home -- Ash, is this right -- with smiles on their faces. I don't think 100 percent.

MR. WILLIAMS: Correct.

MR. PRICE: There is a subjective nature to their reviews.

MR. WENDT: But 90 percent will. And I think the fact that this is -- I don't know what you call public or private, but that this is a governmental agency, for us to be giving out 100 percent to everybody down the trail at a time when we aren't even coming close to meeting the obligation. This has nothing to do with our capabilities. I'm not talking about people's capability. I'm talking about plan design.

MR. COLLINS: So Gary -- Peter Collins again. So, again, the issue that I have -- I don't have an issue with the premise that if everybody gets 100 percent, we might want to look at it. I don't have that issue. I

don't have a disagreement there. I do have a disagreement with saying, Hey, you know, you can't get 100 percent if you don't even come close to getting 6 percent return.

We on the one hand bonus them for performance, but we are also the ones that sign off on asset allocation. So you can't tell them you have to invest this way and then -- and they outperform the market based on that benchmark and then say that's not good enough.

MR. WENDT: I'm okay about your bonus, Peter.

MR. COLLINS: I do it for free. And you know what? I'm in a different business. Right? So I'm supposed to outperform the market by a lot.

MR. WENDT: Your business in this case has to do with operating in the IAC --

MR. COLLINS: Right. I just think it's unfair to say, Hey, here's your asset allocation. You can't have a big tracking error, and you have to follow this -- you know, and here's your benchmark. But at the same time say, Well, you know, you didn't do good enough, when you still outperformed your benchmark.

MR. WENDT: You understand my point. Any plan which has 90 to 100 percent of the people getting 100 percent bonus in any year, in any year, is not a good plan. It just isn't, from a management standpoint.

MR. COLLINS: That I don't necessarily have an issue with. I can't really argue with you on that.

MR. WENDT: I think as guardians of the taxpayer funds, it's not going to look real good. I don't know whether this will get broadcast or not. I don't know how much information goes out. But if anybody wants to make an issue about giving 100 percent when you made less than 1 percent --

MR. COLLINS: There again, now, you're losing me on that. They made less than 1 percent because we gave them an asset allocation and a benchmark and said, Hey, you can't have too much tracking error. So on one hand we said, hey -- you know, sort of like, here's your ceiling, and then we penalize them for not busting through the ceiling.

MR. WENDT: I understand you disagree.

MR. WILLIAMS: Gentlemen, can I help you here?

MR. WENDT: I understand you disagree with me on that part. I'm not going to change. I don't think we should do this. I think we should have a plan that's designed with some flexibility to take care of the taxpayers.

MR. DANIELS: I think there are a couple of points here that we're looking at. First, Gary, we're looking at a data point of one. This is the first plan that

we've been through. The back-testing, the plans three, five and ten years ago rather than over the whole course, 43 percent, might be something we might want to take a look at.

As far as giving a bonus when we don't make money, I remember the days when Lee Iacocca took over Chrysler's turnaround, and the whole public went crazy because he got a $20 million bonus and they lost money. Well, he got the bonus because they lost less money than they would have.

MR. WENDT: Les, we are an organization that works for the taxpayers of the state, and that should be taken into consideration. But if everyone disagrees with me, I don't have a problem.

MR. WILLIAMS: Mr. Chairman, this is Ash. Can I say something?

MR. PRICE: Yes, Ash. Go ahead.

MR. WILLIAMS: Gary, I don't disagree with you, and I am sensitive to your points. And I can absolutely assure you that they will be taken into consideration as we go through this plan. And the likelihood of a sample of 200 human beings all being 100 percent on their incentive comp might happen in Lake Wobegon, but I don't think it happens in Tallahassee. So I think we're rushing to judgment

about a problem here that we don't know that we have yet. Let's get through the process and come back to it and see where we are.

MR. OLMSTEAD: A real quick question. Vinny Olmstead. So just -- again, it's sort of high level. But when you look at we're greater than 50 percent, in determining how we came up with this plan, right, was there any contemplation of, you know, above 50, above 70 or above 80 with where we fell out? I guess it's a question on the construct of the plan. Is any of that -- was it contemplated?

MR. WILLIAMS: Yes. This thing was under construction for two or three years, with extensive public meetings and discussion and input from an awful lot of folks.

MR. OLMSTEAD: I agree with Peter with regard to I don't have a problem with earning 100 percent. The other question I have, though, is if you're just above 50 percent, you know, does that mean there's 47 percent that are outperforming? I don't know if that's the right way to look at it. Does that mean it should equal the 100 percent, which is more a conversation around the construct of the plan that I don't have historical knowledge of.

I see both sides of the story. Gary, I don't

disagree with you. I think there is contemplation of everybody being paid out 100 percent. So I don't have a strong conviction, because I'm new, but I do think it's a worthwhile discussion, at least for next year.

MR. JONES: I think one mitigating factor that we've got to recognize -- and I think it comes back to Gary's comment about the taxpayers. This is not the normal type job. I think we all recognize these are highly trained investment professionals, usually working in New York or Atlanta, to get them to Tallahassee and to do it with very little turnover.

You know, I would agree with Gary that many people -- if we asked a state teacher if she thought anybody ought to make 200,000, the answer would be, hell, no. If you ask her about her retirement fund in 15 years, maybe, maybe. But that's why we're there, is to make sure we're protecting her.

I think the biggest thing we need to do -- somebody said it earlier -- is to protect these people and Ash and make sure we maintain a stable environment to outperform not only our peers but to make sure we take care of the retirement needs of the State of Florida employees over the long haul. And, I mean, that's just not the normal job. It's not a 3 percent raise.

MR. WENDT: Once again, I want to make clear with Michael Price and with you that we should pay these people all we can, all we can get away with. But a bonus plan that has everybody getting max is not a well designed plan. And I will not be -- I'm convinced of that.

MR. COBB: Mr. Chairman, this is Chuck Cobb again. I wasn't going to say anything.

MR. PRICE: Yes, Chuck. Please go ahead.

MR. COBB: Now I'm going to talk twice today. First, I think that Gary is on a reasonable point. My answer to Gary is that, in my judgment, our pension plan is really well managed. And I compare it to the other eight or nine pension committees I'm on. And it is by far the best results, and it consistently is one of the best results.

I know for a fact that the average foundation last year had a minus 2 percent return. And so we were -- and so while maybe the average state pension fund was down one-tenth of 1 percent, the average foundation in this country was down even more. So our performance was really very good. And so I'm comfortable with us giving max.

My problem would be -- and fortunately this is not the case. But this is where I may be agreeing with

Gary. If in fact we were in the bottom quartile of other pension funds and we were basically break-even or six-tenths of 1 percent positive and we were in the bottom quartile of other pension funds or other endowments in this country and we were paying max, even though we beat our benchmark, then I would have a concern.

But since we're not there -- but maybe Gary has a good point, that this is a good time to review our quantitative criteria, which -- and you've heard my position, that I think peer review is important.

MR. WILSON: One more comment from Josh here. I understand the commentary and the concern. Whoever mentioned that this is a one data point argument I think is a great one. If we have 100 percent payout ten years in a row, Gary, I would absolutely say fire us. I think one year perspective, we probably need a little bit more perspective to understand how it's going to play out over time.

We modeled it backwards, as Ash pointed out, and tried to measure it so that an average year target would be achieved. And that was the goal, because we're trying to motivate performance better than it's been. So I think one year is a short sample and, you know, let's take a look at it next year.

MR. WENDT: It would not be important if we were in year seven. But in year one, when you start right out and you see that this program is poorly designed (inaudible). But that's not the point. The point isn't the quality of the people. It is do we have a plan that reflects better payments for better people and not such good payment for (inaudible).

MR. COLLINS: Mr. Chairman, Peter. As I said, I agree with part of what Gary is saying. I disagree with part of it. But I do think that it probably is a topic for a conversation, but a longer conversation, maybe an in-person conversation at a future subcommittee, the next subcommittee meeting. I do think that we should talk a little bit about it.

But I think for the task at hand today, I think we all, even Gary, approved. So I don't know if everybody has it on their calendar to stay on the phone call another hour, but I do think it needs some discussion.

MR. PRICE: That's fine. I'm all in favor of that. If there are any other comments, I welcome them. If not, we can move for adjournment and we can discuss this on the 19th.

MR. JONES: Mr. Chairman, just a question. I noticed in the minutes that you needed an approval for April 21st minutes.

MR. PRICE: Yes. Would someone please move it?

MR. JONES: So moved.

MR. COLLINS: Second.

(Ayes)

MR. PRICE: Thank you. Okay. Any other business? So we've had our vote. We've had a very good discussion, and we'll see you on the 19th. Thank you very much.

(Whereupon, the meeting was concluded at 2:55 p.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)

COUNTY OF LEON)

I, Jo Langston, Registered Professional Reporter, do hereby certify that the foregoing pages 3 through 37, both inclusive, comprise a true and correct transcript of the proceeding; that said proceeding was taken by me stenographically and transcribed by me as it now appears; that I am not a relative or employee or attorney or counsel of the parties, or a relative or employee of such attorney or counsel, nor am I interested in this proceeding or its outcome.

IN WITNESS WHEREOF, I have hereunto set my hand this 22nd day of September 2016.

Jo Langston

JO LANGSTON
Registered Professional Reporter

Attachment 2

Incentive Plan Design
ED/CIO - FY 2016-17

- Individual component level for ED/CIO position accounts for 15% of total award
- Organizational and individual component payouts at various incentive achievement levels are shown below. Evalaution criteria for individual component was determined by IAC Compensation Subcommittee in June 2015.

		Incentive as a % of Salary		
	Mix	Threshold	Target	Maximum
Total Incentive Opportunity	100%	17.500%	35.000%	52.500%
Organizational Component	85%	14.875%	29.750%	44.625%
Individual Component	15%	2.625%	5.250%	7.875%

Incentive Opportunity Breakdown (Annual Salary = $389,500)				
	Mix	Threshold	Target	Maximum
Total Incentive Opportunity	100%	$68,162	$136,325	$204,487
Organizational Component	85%	$57,938	$115,876	$173,814
Individual Component	15%	$10,224	$20,449	$30,673

Attachment 3A

ED/CIO Incentive Plan Evaluation Process - FY 16-17

ED/CIO Individual/Qualitative Measurement

The sections below outline the approved criteria and process for evaluating the ED/CIO's individual/qualitative performance, which constitutes 15% of his incentive award (the other 85% of the award is determined by the level of outperformance of the FRS Pension Fund). Any changes to the criteria for the next Performance Period (fiscal year) need to be determined and communicated to the ED/CIO prior to July 1.

ED/CIO Individual/Qualitative Performance Criteria

In line with the overall framework for the incentive plan, criteria for the individual/qualitative performance portion of the ED/CIO's incentive award initially approved in June 2015 are: (1) Overall Mission; (2) People; (3) Efficiencies/ Infrastructure/ Operations; and (4) Interaction with the Investment Advisory Council, PLGAC and Audit Committee. The Qualitative Evaluation Form on the following pages includes more descriptive information regarding each rating area.

Process and Schedule for ED/CIO Qualitative Performance Rating

In June 2015 it was decided the Compensation Subcommittee will rate the qualitative performance of the ED/CIO and recommend to the full IAC the amount of incentive to be awarded for the Performance Period. The IAC will vote to approve or disapprove the recommendation.

July 1-13: ED/CIO prepares summary of accomplishments in each of the four areas (Mission, People, Efficiencies/Infrastructure/Operations, and Interaction with IAC, PLGAC and Audit Committee). As part of the summary, the ED/CIO may want to encourage the individual Compensation Subcommittee or IAC raters to speak with individual members of the Audit Committee and/or PLGAC to gain additional perspective on interactions with them.

By July 15: ED/CIO sends his/her Summary to raters (members of Compensation Subcommittee) along with the attached evaluation form.

By July 31: Raters evaluate ED/CIO and return form to Mercer. Mercer may seek clarification of the ratings and/or comments of individual raters.

By August 31: Mercer compiles final ratings and all final comments from raters and sends them to the ED/CIO, who will compile the materials for a noticed public meeting of the Compensation Subcommittee to review/discuss the evaluation with ED/CIO and provide an overall recommendation to Trustees. The Subcommittee will present its recommendation to the IAC for its approval or disapproval prior to sending the recommendation to the Trustees.

Following the public meetings of the Subcommittee and the IAC, the Subcommittee Chair communicates the recommendation regarding qualitative incentive award and supporting rationale to Trustees, with a copy to IAC members, as materials for a noticed public meeting of the Trustees.

Final Action: Trustees consider recommendation in public meeting.

Attachment 3B

STATE BOARD OF ADMINISTRATION FLORIDA

EXECUTIVE DIRECTOR PERFORMANCE EVALUATION SUMMARY

AUGUST 2017

Jon Mason
Josh Wilson

Atlanta

INTRODUCTION

- Mercer has advised State Board of Administration Florida to a variety of human capital needs since 2012.
- Mercer was asked to collect and disseminate a summary of the performance evaluations completed by the Compensation Subcommittee of the IAC. Performance reviews were completed by the following members:
  - Michael Price
  - Gary Wendt
  - Peter Collins
  - Les Daniels
  - Vinny Olmstead
- The following pages include an overall summary of the responses and detailed pages on the survey questions

EXECUTIVE SUMMARY

Question	Average Rating
Overall Mission	4 out of 4
People	3.8 out of 4
Efficiencies/ Infrastructure /Operations	3.6 out of 4
Interaction with Committees	3.6 out of 4
Individual Rating	4 out of 4

- The Executive Director received the highest scores related to the overall mission and the individual rating with all “exceeds” ratings for these two questions.
  - The marks were high across all questions with the remaining three questions falling in-between “meets” and “exceeds” on average

- Mercer converted the verbal rating scale to a numerical scale as follows:
  - Exceeds= 4 out of 4
  - Meets = 3 out of 4
  - Below = 2 out of 4
  - Poor = 1 out of 4

OVERALL MISSION

- The rating for this category should reflect the degree to which the ED/CIO has:
- Assured appropriate alignment with the investment policy of the SBA's mandates (e.g., FRS Defined Benefit Pension Fund, FRS Investment Plan, Florida PRIME, Florida Hurricane Catastrophe Fund (FHCf), etc.), considering the long term needs of the relevant fund, the risk tolerance of SBA Trustees, and the perceived market environment.
- Provided leadership for effective functioning of the SBA, FHCF and the Office of Defined Contribution Programs.
- Maintained/strengthened the reputation/brand and performance of the SBA in relation to its large public pension fund peers; external communications and issue management

4 OUT OF 4

Comments:

- *"Ash has clearly exceeded expectations and exemplifies both the mission and vision. The culture of accountability and credibility should be pointed out"*
- *"Very impressed after 5 years of working team and Ash"*

PEOPLE

- The rating for this category should reflect the degree to which the ED/CIO has:
  - Developed subordinate staff
  - Recruited and retained key talent

3.8 OUT OF 4

Comments:

- *"Perhaps the key aspect, Ash has exceeded expectations. Recruiting and maintaining talented team members in the public sector, and in Tallahassee is no small task"*
- *"High quality, dedicated, at below market compensation rates"*

EFFICIENCIES/INFRASTRUCTURE/OPERATIONS

- The rating for this category should reflect the degree to which the ED/ClO has:
  - Assured the development of organizational structures, systems and processes that enable effective functioning of the SBA, FHCF and the Office of Defined Contribution Programs.
    - This includes such areas as communication of knowledge; development and institutionalization of systems and structures to enhance performance and control risk; efficient acquisition and use of data and other resources; business continuity planning, etc.

3.6 OUT OF 4

Comments:

- *"Excellent"*
- *"Ash's blend of high competency in government, investing and leadership has aided to the success of Investment success"*

INTERACTION WITH IAC, PLGAC & AUDIT COMMITTEE

- The rating for this category should reflect the degree to which the ED/ClO has:
  - Maintained effective working relationships with individual IAC members and the Council as a whole, with members of the Audit Committee, and members of the PLGAC, on matters within the concern of each body.
  - Provided requested information and transparency. Note: As part of the evaluation process, individual raters may speak with individual members of the IAC, Audit Committee and/or FLGAC to gain perspective on ED/CIO interactions with them.

3.6 OUT OF 4

Comments:

- *"Prompt, clear and appropriate"*
- *"Minimal/no communication other than once each three month meetings and repetitive form of stats with no comments"*
- *"Extremely good communication, open, transparent and honest"*

OVERALL INDIVIDUAL/QUALITATIVE PERFORMANCE RATING FOR THIS PERIOD

4 OUT OF 4

Note: There was no comments section provided for this final rating

Appendix to Attachment 3B

STATE BOARD OF ADMINISTRATION
OF FLORIDA

1801 HERMITAGE BOULEVARD, SUITE 100
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

RICK SCOTT
GOVERNOR
CHAIR

JIMMY PATRONIS
CHIEF FINANCIAL OFFICER

PAM BONDI
ATTORNEY GENERAL

ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

July 14, 2017

Mr. Michael Price
MFP Investors LLC
667 Madison Avenue
New York, NY 10065

Dear Michael:

Consistent with the process adopted by the IAC Compensation Subcommittee and affirmed by the IAC, following is my self-assessment, inclusive of the fiscal year ended June 30, 2017, together with a Qualitative Evaluation Form (attachment 1) for you to complete and return to Josh Wilson at Mercer by July 31. For your convenience, an addressed, stamped envelope is enclosed for this purpose. Mercer will review the responses and may contact responders for clarification. They will then compile the ratings and final comments from raters and return them to me by August 31. I will share them with you and the other Subcommittee members and compile materials for a noticed public meeting of the Subcommittee to discuss and adopt a recommendation for the IAC. Please see "ED/CIO Incentive Plan Evaluation Process – FY 16-17" (attachment 2) for additional process details.

As a reminder, in keeping with Florida's Sunshine Law, please do not discuss this evaluation with any other members of the IAC. All members will have the chance to discuss this evaluation at the noticed public meeting planned for later this year.

Background

Upon being triggered by total fund performance as of fiscal year end June 30, implementation of SBA's incentive compensation structure is based on achievement as evidenced by quantitative investment performance measures and qualitative assessment of each incentive plan participant's contributions to the accomplishment of SBA's objectives. These are summarized at a high level in our Mission and Vision Statements:

Our mission is to provide superior investment management and trust services by proactively and comprehensively managing risk and adhering to the highest ethical, fiduciary and professional standards. Our vision is to be the best public sector investment and administrative service provider while exemplifying the principles of trust, integrity and performance.

As Executive Director and CIO, my priority has been and continues to be building and maintaining our organization's team, culture, reputation, credibility and resources at a strength that empowers mission and vision fulfillment. This is consistent with the Trustees' delegation of authority to the Executive

Director & CIO. Our most visible output is investment results, the goodness or inadequacy of which is readily seen. What is less visible is the team building, policy and strategy formation, risk management and execution. If the team, culture, processes and resources are right, the probability of investment outcomes that earn trust, enhance reputation and build brand value is vastly enhanced. The result is a virtuous cycle where our credibility and performance help garner critical policy support from key SBA stakeholders (Trustees, Legislature, local governments, beneficiaries, taxpayers, media, etc.), which in turn, positions us as a serious, stable, and therefore desirable investment partner in the marketplace. This enables us to capture superior deal flow and more favorable terms and pricing, which ultimately drives the performance that earns trust, enhances reputation and builds brand value. I make it my business to ensure that the SBA executes effectively at all levels of this cycle.

Not so long ago, this cycle was operating in reverse. The event that led to my returning to the SBA was a crisis of confidence and reputational damage arising from liquidity problems in the face of credit downgrades and mass redemption requests from local government clients of a cash pool SBA managed for their benefit. Staff vacancies and resource constraints had created control and oversight gaps. Occurring at the onset of the great financial crisis, the cash pool problems led into a protracted period of painfully public SBA criticism and doubt that worsened with the GFC. The Trustees and Legislature heightened oversight and a new advisory body, the Participant Local Government Advisory Council (PLGAC), was created for the express purpose of overseeing SBA's management of the local government pool. At this June's joint IAC/PLGAC meeting, the PLGAC members recommended dissolution of the PLGAC, noting a high degree of satisfaction with and confidence in the SBA's management of the rebranded cash pool, Florida PRIME. PRIME clients appreciate and respect the safety, liquidity and performance they have experienced since the challenges of Q4 2007. This outcome reflects years of focus on getting all the inputs to the virtuous cycle right, as we do in all of SBA's businesses.

While effective strategy execution and policy engagement describe my responsibilities at a high level, the purpose of this letter is to communicate specifically what I have accomplished over the past year for your consideration. As you are aware, evaluation of the Executive Director & CIO and recommending an appropriate level of qualitative incentive compensation falls to the IAC Compensation Subcommittee, which may also make a recommendation on base compensation. Final action on the ED/CIO compensation is reserved for the SBA Trustees. Following are my thoughts on my contribution and accomplishments relating to each of the four central performance areas for the ED/CIO to be evaluated by the Subcommittee and addressed on the Evaluation Form.

1) Overall Mission

I believe the SBA continues to be in its strongest position ever, reflecting the performance of a stable, highly competent team under thoughtful, consistent leadership that recognizes and rewards merit and embraces constructive change. Investment performance is an obvious threshold metric for management success. While preliminary FY year end numbers clearly suggest value added in all asset

classes and total fund relative to benchmarks; the incentive plan documentation requires that we rely on audited numbers (available Q4) so that final market values and necessary income/expense accruals are included and the resulting performance calculations are definitive. The focus of this evaluation is qualitative so I will focus on elements of my management performance beyond specific investment returns and over/under performance. Examples include:

- SBA clearly has historically performed well, continually adding value relative to benchmarks. Initial estimated investment performance numbers for FY 16-17 are sound; total pension fund return is 13.69%; we grew the FRS Trust Fund by $12.2 billion, net of distributing $6.8 billion in benefit payments. The FRS Investment Plan (DC) also had a good year, returning 13.36%, 79 bps (unaudited) ahead of target. All other major mandates likewise beat benchmarks.
- Controls and risk management were effective as evidenced by a lack of material compliance or audit issues; all asset classes and the total fund remained within budgeted risk tolerances.
- While adding value the SBA has done so with all in costs of 40.5 bps, among the lowest of our US large pension fund peers.
- An increasing portion of SBA assets are managed in house, 43.3% at December 31, 2016 vs 36.3% at December 31, 2010. This holds down costs but requires competent, stable professional talent and support for portfolio and risk analytics, trading, systems, portfolio accounting, compliance, etc.
- SBA investment policies for FRS Pension (DB) and Investment (DC) plans, together with other SBA "client" mandates (Cat Fund, FL PRIME, Lawton Chiles Endowment Fund) are reviewed in public meetings of the IAC and affirmed to be appropriately aligned with legal and client requirements by expert third party investment consultants who contractually are fiduciaries to the SBA. Long-term evidence is that these policies have been well chosen and effective in achieving desired investment results, within stated risk tolerances.
- SBA is a very visible leader in US and global investment circles and has been recognized in many ways. During FY 16-17, I served on the Institutional Investor Investor Roundtable and have continued board service with the Council of Institutional Investors, Institutional Investor/CNBC Delivering Alpha, Pensions & Investments Global Future of Retirement, National Institute for Public Finance, Managed Funds Association, Alternative Investment Forum, Robert Toigo Foundation, etc. The Yale School of Management is now teaching a case based on SBA's alternative investment program. SBA was also honored to win two Hermes Awards for excellence in beneficiary plan choice education.
- Control and compliance is working well with "tone at the top" balancing commitment to achieving desired investment results while always staying within ethical, legal, regulatory, compliance and fiduciary bounds. These standards are extended to our external investment partners; they are required to annually certify compliance with a range of relevant policies and statutory obligations. Annually, the SBA undergoes over 100 audits among our business units and investment holding companies. The fact that we have had clean opinions on all our financial statements provides an objective confirmation of the quality of our control environment.

- The Florida Hurricane Catastrophe Fund is financially stronger than it has ever been, through a combination of good luck and good leadership driving prudent policy. We have taken advantage of record low reinsurance and interest rates to transfer $1 billion of loss liability for the 2017 hurricane season. The Cat Fund again has full liquidity to meet its statutory maximum single-season risk liability for the second time since its 1993 inception.
- Florida PRIME AUM ended FY 16-17 at $9.33 billion, gaining $1.54 on the year, 20% annual asset growth, reflecting the restoration of confidence as the top performing, lowest cost, and most liquid and transparent cash management option for Florida governments.

2) People

Thanks largely to the IAC's support of the SBA Comp Plan now in full effect, talent recruitment and retention is far stronger that it was just a few years ago. Over the FY just ended, we had 20 terminations, mostly retirements, some talent upgrades and a few moves for personal reasons. We completed 21 new hires and are very pleased with the quality of people recruited, successfully bringing in great talent from both the private and public sectors and many regions of the US. While we continue to have succession exposure, with 25% of management retirement eligible over the next few years, we have the tools in place to manage and mitigate the human capital risk.

3) Efficiencies/Infrastructure/Operations

Initiatives in these three areas have been motivated and accelerated by a new internal budget process, which subjects each business unit's budget request to peer review; this brings relative priorities into focus quickly and gives the entire management team ownership of resource allocation decisions. Linking priorities of our strategic plan to budget formulation has helped too. Motivationally, the new compensation structure has been a powerful positive because incentives can be used to motivate smarter resource use at all levels. Examples include:

- IT Information Security – We continue to enhance our information security profile. Over the last year we completed an internal audit IT General Controls Advisory Engagement and engaged additional private consulting services to evaluate the strength of our IT controls and information security capabilities. Stemming in part from these activities, we have requested and received budget support for the addition of a dedicated Information Security Manager, which we plan to fill in the fall of 2017.
- Disaster Recovery and Business Continuity continue to be enhanced and tested. Our Disaster Recovery and Business Continuity Plans received a real-time, live event test this past year with Hurricane Hermine. Although back-up building power was temporarily and unexpectedly affected during the storm, SBA staff was able to manage the event with minimal disruption and no loss to the SBA. Much our success on this point can be attributed to the extensive preparation SBA staff undertook as the storm approached to ensure all necessary transactions,

wires and investment activity was completed prior to the planned building closure. All of which was in accordance with our business continuity plans.

- Defined Contribution—This past year Defined Contribution staff took the opportunity to update its guided choice platform on the MyFRS.com portal. The legacy system had been in place since the early 2000s. Defined Contribution has just completed its competitive selection process for a new vendor for this product and expects an updated and improved system to be completed this year.

4) Interaction with the Investment Advisory Council, Participant Local Government Advisory Council (PLGAC) and Audit Committee

Our experience working together on the IAC speaks for itself. I therefore defer to your judgement as to the quality and productivity of our relationship. With regard to the PLGAC and Audit Committee, I have attended and actively participated in almost all of their meetings, built relationships with the members and together resolved issues big and small. It might be helpful for you to contact some of the members of the PLGAC and Audit Committee to hear their perception of my interaction with them.

Thank you for your service on the IAC and especially for stepping up to the additional commitment of serving on the Compensation Subcommittee. As you can see from several of my comments above, your work has made a real and valuable difference for our team and organization.

Best regards,

Ash Williams

cc: Josh Wilson

Attachment 3C

MERCER
MAKE TOMORROW, TODAY

3560 Lenox Road, Suite 2400
Atlanta, GA 30326
jon.mason@mercer.com
www.mercer.com

MEMO

TO: Michael Price, Chairman, Compensation Subcommittee of the Investment Advisory Council, State Board of Administration
DATE: August 30, 2017 (Revised 9/20/2017)
FROM: Jon Mason, Principal, Mercer
SUBJECT: Mercer's Review of SBA Compensation study and Salary Recommendation for Executive Director/Chief Investment Officer (ED/CIO)

Dear Mr. Price,

In 2012-13, Mercer was engaged to conduct a compensation study for the State Board of Administration of Florida (SBA). Near the conclusion of that study, Mercer issued a letter of recommendation to Chuck Newman, your predecessor as the Chairman of the Compensation Subcommittee of the Investment Advisory Council, State Board of Administration with regard to the SBA's ED/CIO (Mr. Ash Williams) compensation. The recommendation was to increase the ED/CIO's annual salary to $410,000 which approximated the median of the five largest public pension funds in the United States. Mr. Williams' salary was adjusted from $325,000 to $367,500 effective 12/10/13 and adjusted again to $389,500 effective 12/1/2014. Mr. Williams' salary was not adjusted in 2015.

In 2016, the SBA refreshed the analysis done in 2013 but did so internally (as a fee savings measure) and Mercer reviewed and validated the work. In Mercer's view, the process undertaken by the SBA was appropriate and consistent with the approach Mercer would have taken. Mercer's recommendation for 2016 was to increase Mr. Williams' base salary to $425,000, however Mr. Williams' base salary was actually adjusted to $411,000, which is his current base salary amount.

This year, the SBA again conducted the ED/CIO salary analysis internally and has asked Mercer to review the analysis and provide a base pay recommendation for the ED/CIO. We again believe the process undertaken by the SBA is reasonable and consistent with past practices.

Annual Review of CIO's performance

Mercer received feedback from all five members of the Compensation Subcommittee pertaining to the annual performance of the ED/CIO. Mr. Williams received high marks in all categories, with all Subcommittee members giving the highest possible ratings with respect to Mr. Williams' overall individual performance. The Subcommittee has consistently communicated its desire to retain Mr. Williams and the intention to provide market competitive compensation to all SBA employees, including Mr. Williams.

Mercer's Recommendations Regarding SBA's ED/CIO Compensation

The 2016 market data for the SBA pegged the median base salary for CIOs at the five largest public pension funds in the United States at approximately $455,000. Last year, we recommended phasing

in the increase for Mr. Williams' salary by initially adjusting to $425,000 in 2016 and then adjusting his salary again in 2017 to $455,000 to align with market median.

The SBA compiled multiple salary market reference points for Mercer's review which ranged from approximately $460,000 to $490,000. Based on this review, we recommend staying on track and increasing Mr. Williams' salary this year to $455,000 which is the midpoint of the ED/CIO's pay grade. In 2018, Mr. Williams should be considered for another increase, depending on the market at that time and performance.

Additionally, several SBA employees, including Mr. Williams, are eligible for a performance based incentive which is closely tied to the results of the funds. Mr. Williams is eligible for incentive compensation ranging from 17.5% to 52.5% of salary and Mercer remains comfortable that the incentive compensation is reasonable and competitive.

If you have any questions, please do not hesitate to contact me.

Thank you,
Jon

Attachment 4

2016-17 SBA Compensation Update

SBA FLORIDA
STATE BOARD OF ADMINISTRATION

SBA Incentive Compensation Information 2015-16 and 2016-17

2015-16 Incentive Compensation Statistics		
Total Eligible Positions	64	
Total Participants Receiving an Award	57	
Maximum Possible Award	$ 2,126,550	
Maximum Possible Quant. Award	$ 1,786,970	
Actual Quant. Award (Pd. Over 2 yrs.)	$ 1,382,538	
Max. Possible Indv. Awd. (Pd. Over 2 yrs.)	$ 339,580	
Actual Indv. Award (Pd. Over 2 yrs.)	$ 255,999	
Actual Total Award Earned (Pd. Over 2 yrs.)	$ 1,638,535	*
% earned quant. vs max possible	77%	
% earned indv. vs max possible	75%	
% earned vs. max possible	77%	
% of participants earning max award	53%	
Total Awards Pd. In December 2016	$ 869,218	**
Total Awards Deferred to December 2017	$ 769,318	

*(8.1% of SBA budgeted salaries)

* *More than 50% paid out due to two individuals reaching age 65 in calendar year 2016, triggering 100% payout pursuant to the Plan document.

2016-17 Incentive Compensation Information	
Preliminary Results	
Total Eligible Positions	64
Total Participants Receiving an Award	61
Maximum Possible Award	$ 2,126,827
Maximum Possible Quant. Award	$ 1,783,384
Actual Quant. Award (Pd. Over 2 yrs.)	$ 1,662,624
Max. Possible Indv. Awd. (Pd. Over 2 yrs.)	N/A
Actual Indv. Award (Pd. Over 2 yrs.)	N/A
% earned quant. vs. max possible	93%
% of participants earning max quant. award	77%

SBA Base Compensation Update as of December 2016 – Latest Cycle

Non-Incentive Eligible	
Total Employees	126
Non-Incentive Eligible as % of Total Employees	68.1%
Aggregate 2016 Midpoints	10,055,200
Aggregate 2016 Actual Salaries (PT Adjusted to FT)	9,255,223
Salaries as % of 2016 Midpoints	92.0%
Average Years in Job/Grade	4.8
Aggregate Last Increase	313,617
Average % of Last Salary Increase	3.5%
Average Non-Incentive Eligible Salary Increase	2,489
% Increase Range for Last Salary Increase	0.0% - 15.9%
Incentive Eligible	
Total Employees	59
Incentive Eligible as % of Total Employees	31.9%
Aggregate 2016 Midpoints	8,873,300
Aggregate 2016 Actual Salaries	7,462,656
Salaries as % of 2016 Midpoints	84.1%
Average Years in Job/Grade	3.2
Aggregate Last Increase	176,047
Average % of Last Salary Increase	2.3%
Average Incentive Eligible Salary Increase	2,984
% Increase Range for Last Salary Increase	0.0% - 5.5%

Distribution of Salary Increases - Non-Incentive Eligible

Percentage Increase	Number of Employees	Percentage of Employees
No Increase	26	20.6%
.1% - 5%	73	57.9%
5.1% - 10%	22	17.5%
10.1% - 15%	3	2.4%
Greater than 15%	2	1.6%
	126	100.0%
Median % Increase:		3.1%

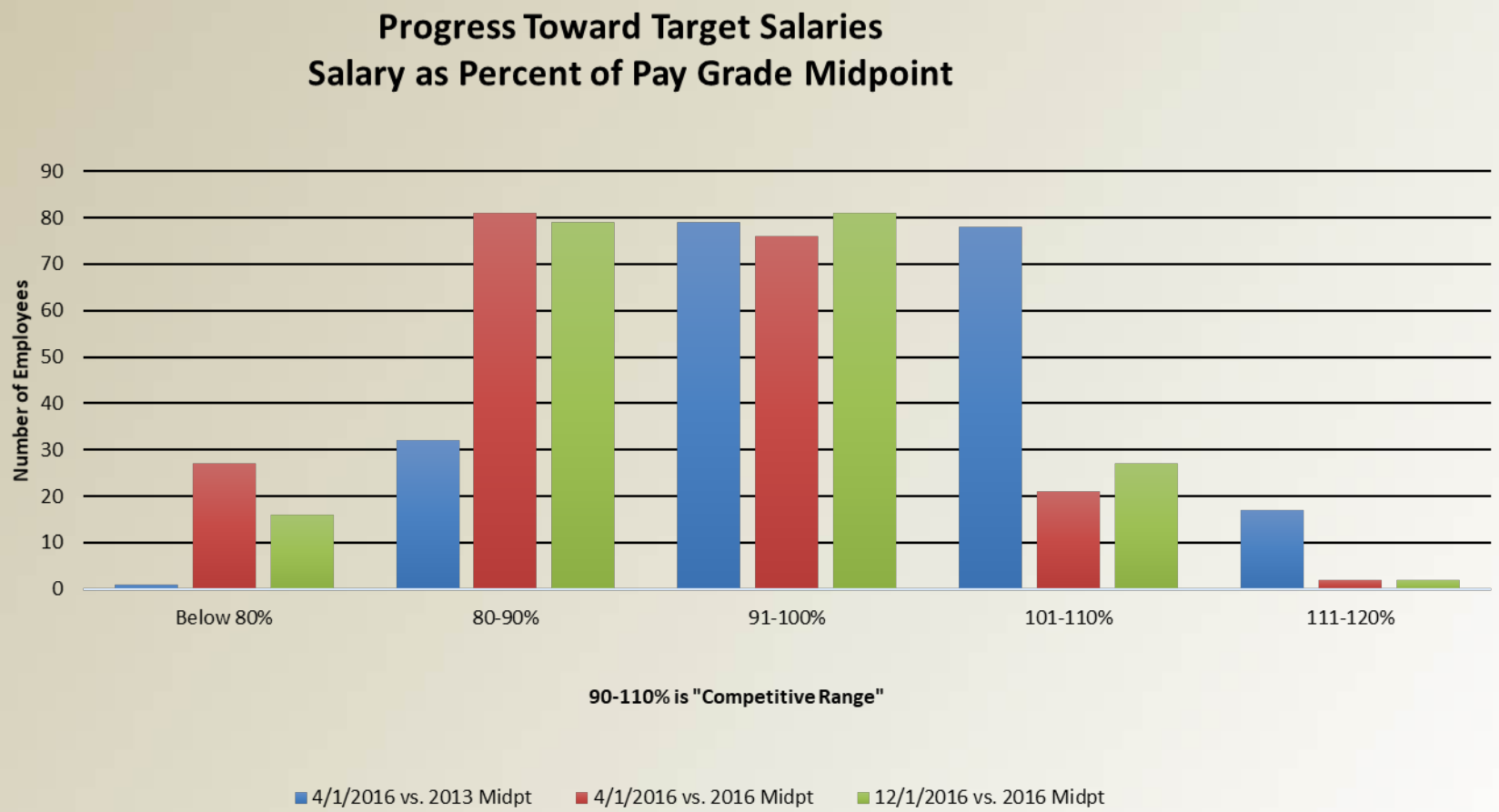
Distribution of Salary Increases - Incentive Eligible

Percentage Increase	Number of Employees	Percentage of Employees
No Increase	5	8.5%
.1% - 5%	51	86.4%
5.1% - 10%	3	5.1%
10.1% - 15%	0	0.0%
Greater than 15%	0	0.0%
	59	100.0%
Median % Increase:		2.2%

*The data on this slide reflect only SBA information and exclude FHCF and ODCP.

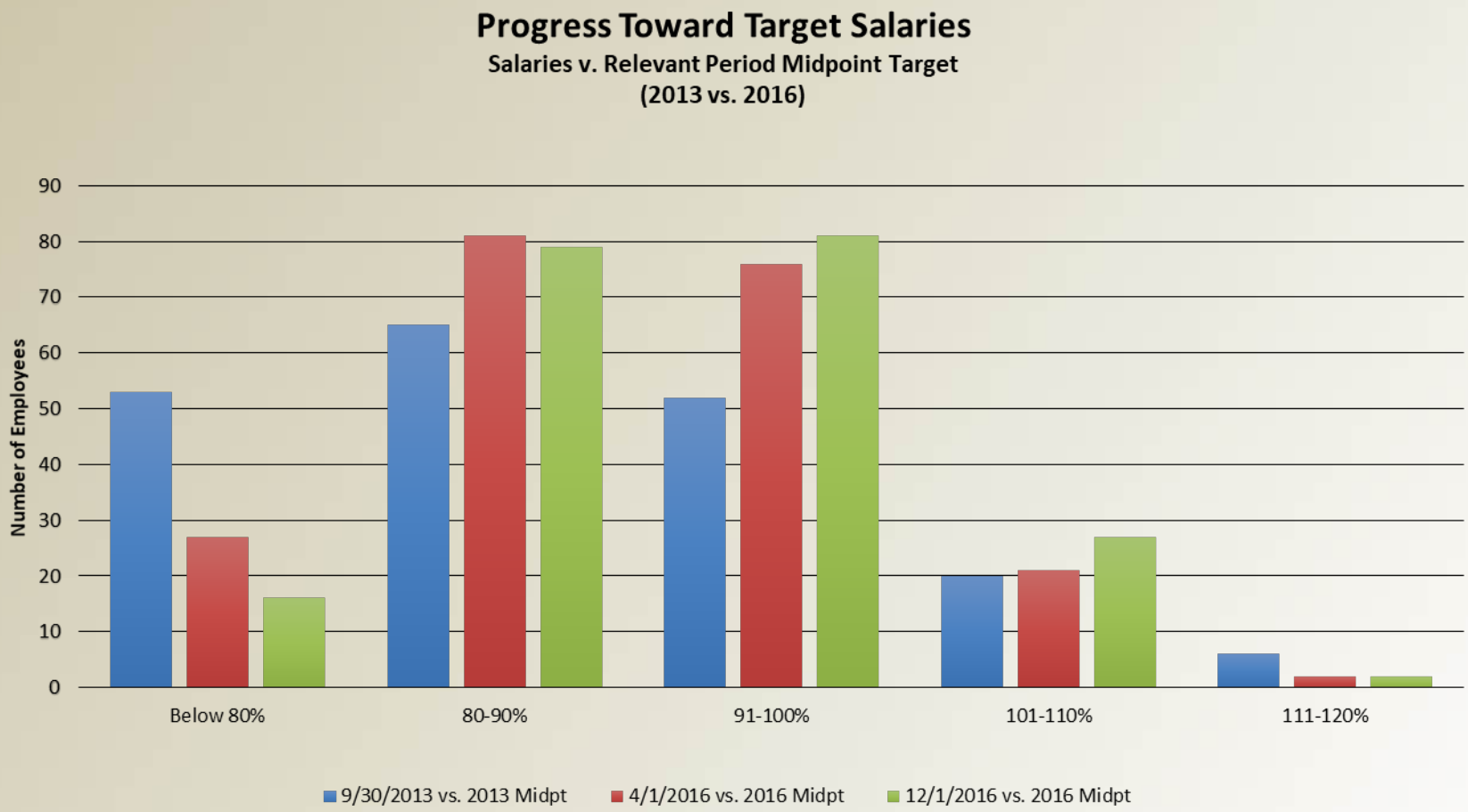
Progress of Salaries Toward Midpoint

(2016 Salary Data)



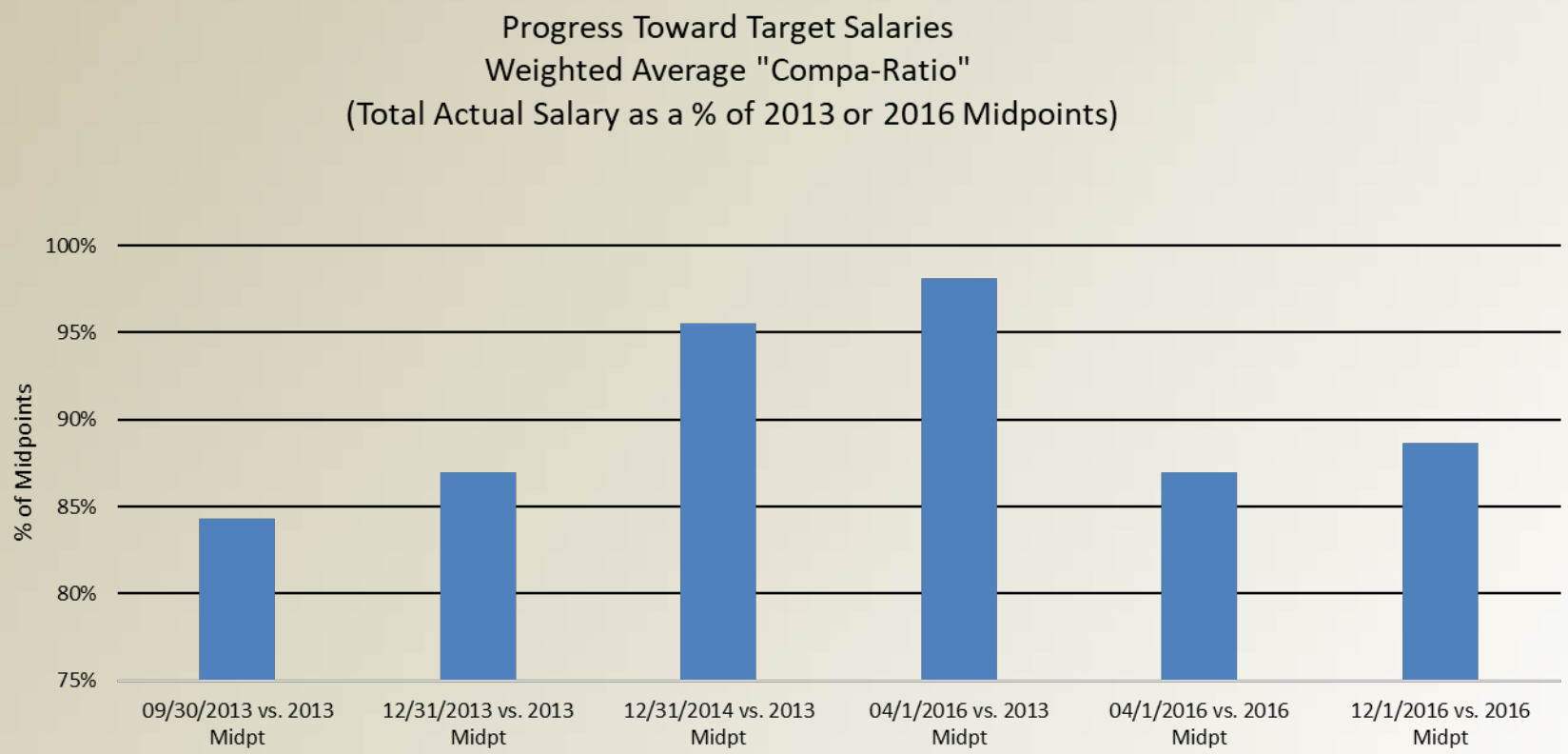
Progress of Salaries Toward Midpoint

(Salaries Compared to Relevant Period Midpoints)

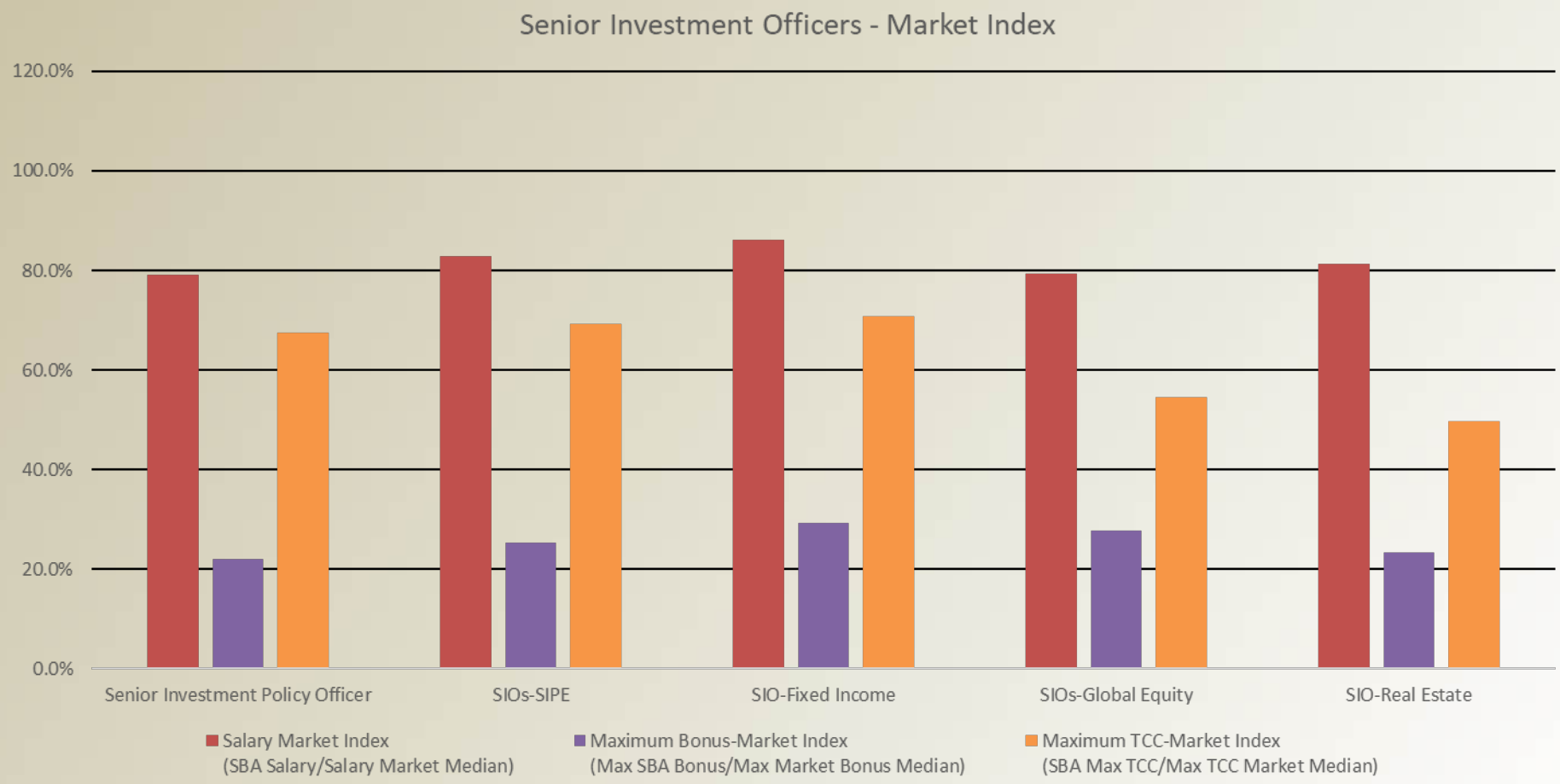


Progress Toward Target Salaries

(Organization-wide Compa-Ratio)

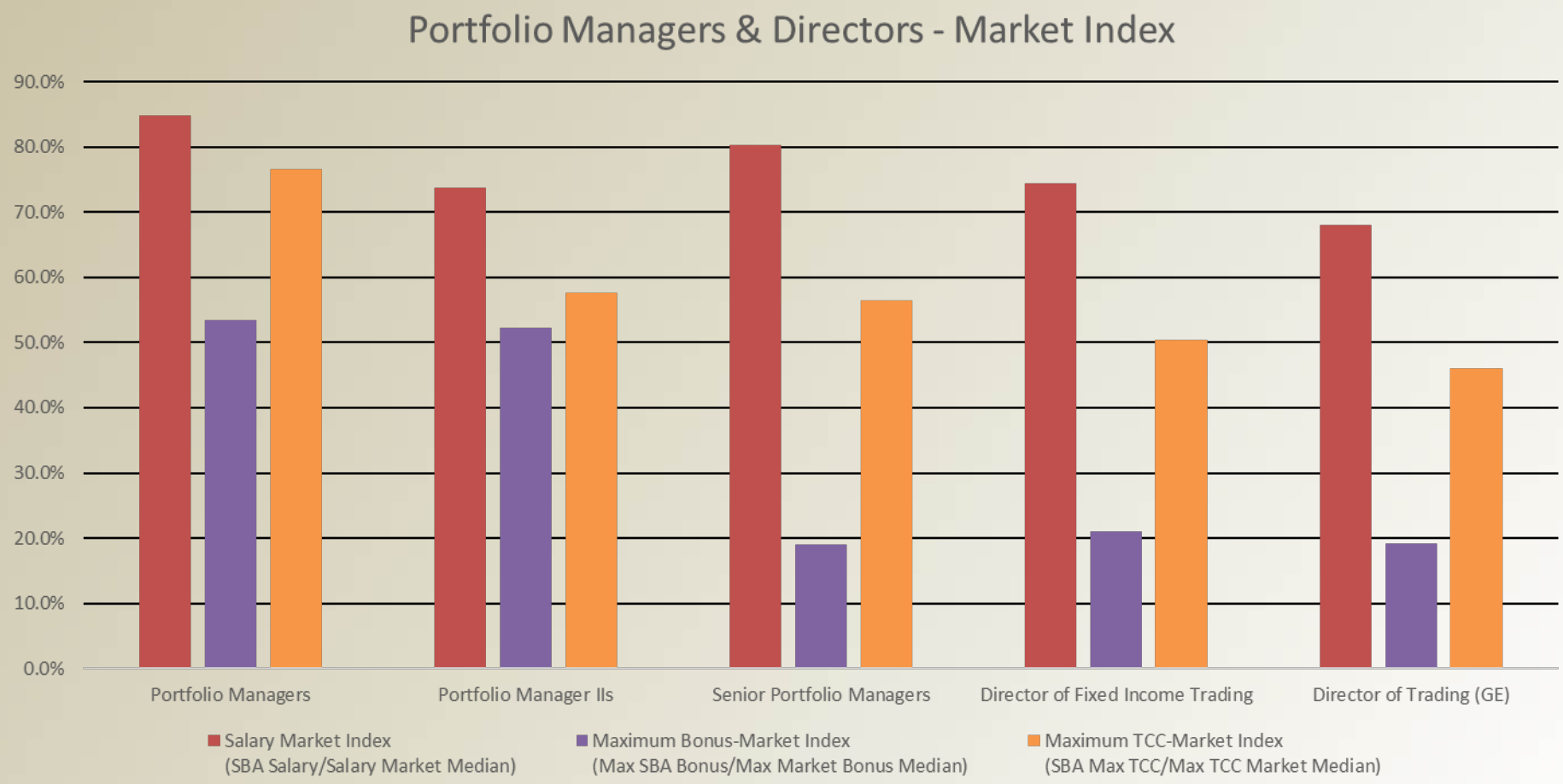


Comparison of Current SBA Compensation to 2016 Market Medians for Senior Investment Officers



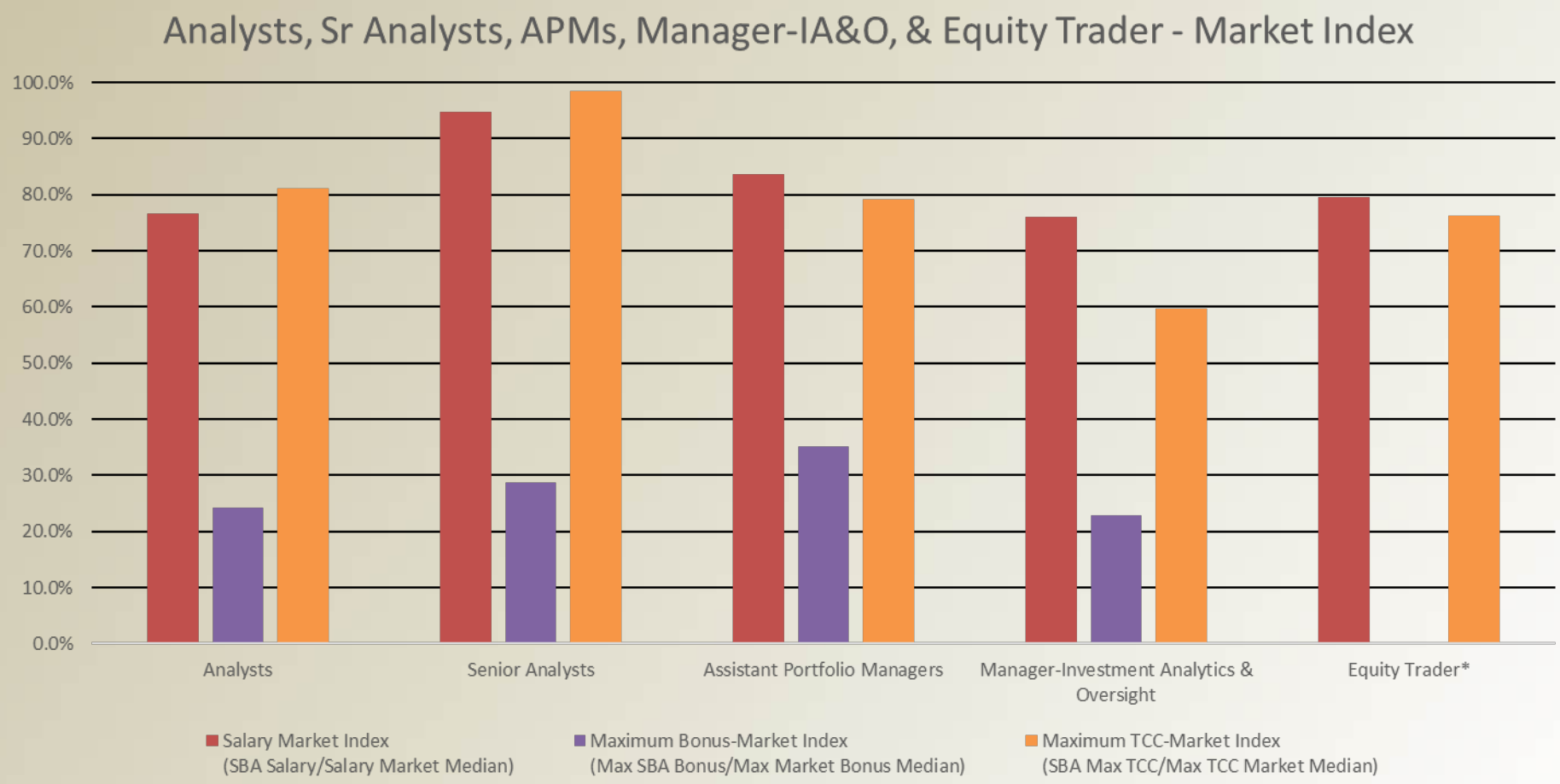
*If the SBA is at 100.0%, then the SBA is doing as well as the median market peer for salary, bonus, or total cash compensation (salary + bonus).

Comparison of Current SBA Compensation to 2016 Market Medians for PMs & Directors



*If the SBA is at 100.0%, then the SBA is doing as well as the median market peer for salary, bonus, or total cash compensation (salary + bonus).

Comparison of Current SBA Compensation to 2016 Market Medians for Analysts, Sr. Analysts, APMs, Manager-IA&O, & Equity Trader

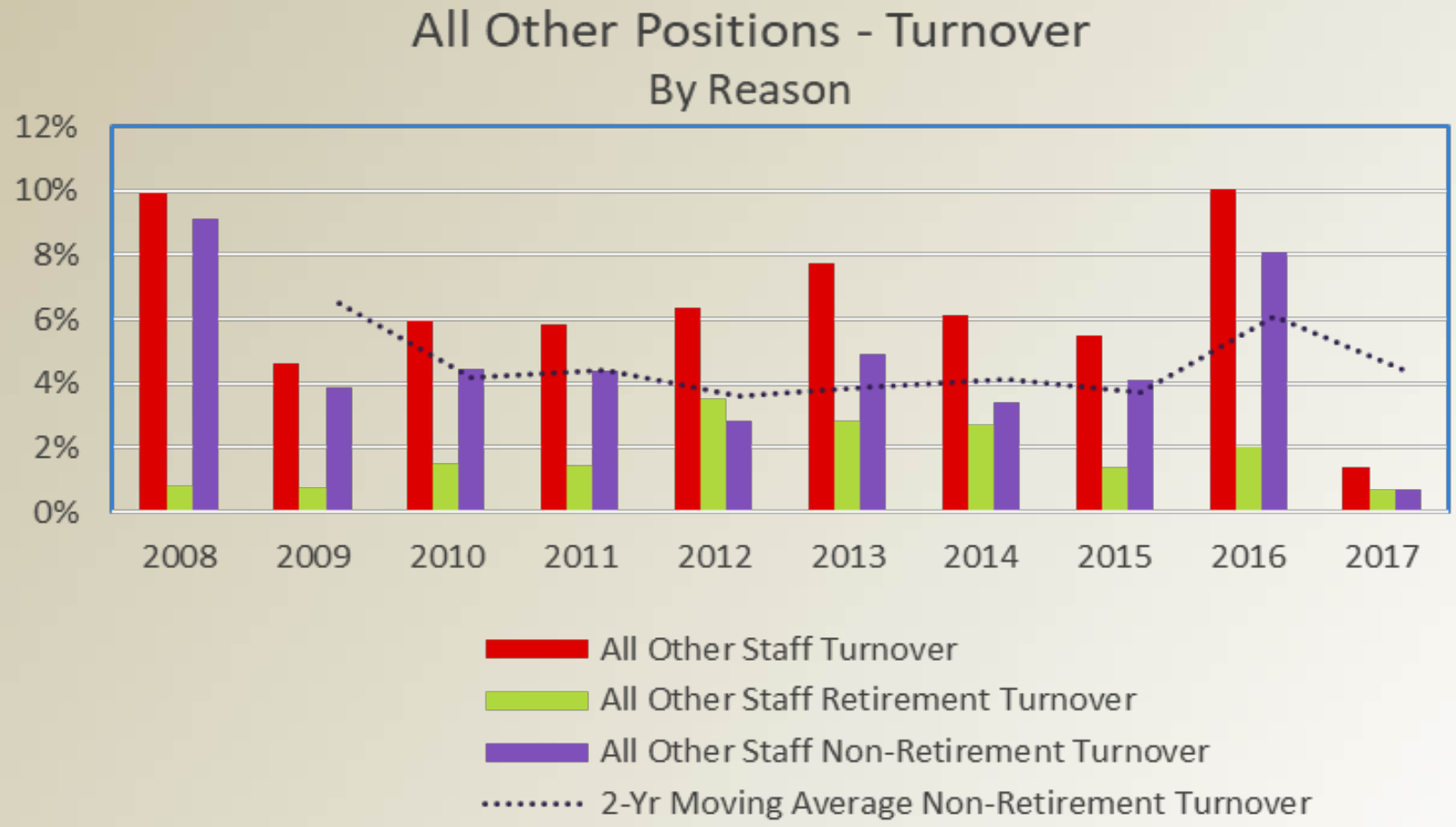


*If the SBA is at 100.0%, then the SBA is doing as well as the median market peer for salary, bonus, or total cash compensation (salary + bonus).
*The median for the maximum bonus-market index was not provided by McLagan for the Equity Trader.

All Staff Turnover – By Reason

Asset Class Staff Turnover – By Reason

Non-Asset Class Staff Turnover – By Reason



FY 2018 Information

- Employee Recruitment & Retention Rate for FY 2018
  - SBA = $900,000
  - ODCP = $37,430
  - FHCF = 60,379
- Non-Recurring Compensation Rate for FY 2018
  - SBA = $2,350,000
  - ODCP = $150,000
  - FHCF = 93,700

Business Unit/Department	12/1/2016 Compa-Ratio	Current Compa-Ratio (08/31/2017)
SBA, ODCP, FHCF	88.7%	88.3%
ODCP	93.0%	93.0%
FHCF	91.4%	91.8%
SBA	88.3%	87.9%
Non-Incentive Eligible	92.0%	91.0%
Incentive Eligible	84.1%	84.2%