**STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS**

# *INVESTMENT POLICY*

Adopted by the Board of Trustees
June 7, 2019

# INVESTMENT POLICY

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# I. Purpose of Investment Policy

This document specifically outlines the investment philosophy and practices of the State Universities Retirement System ("**SURS**" or the "**System**") and has been developed to serve as a reference point for the management of the Defined Benefit Plan[1].

1. Capitalized terms not defined in the text of this document can be found in the Glossary of Terms attached hereto as Exhibit I.

## II. Strategic Objectives

The Strategic Objectives of this Policy are as follows:

- Achieve long-term, sustainable, investment performance necessary to meet or exceed the System's Assumed Rate of Return (set forth in Appendix 1), net of investment management fees;
- Manage the risk and volatility of financial assets in the Portfolio;
- Control fees and expenses related to managing the Portfolio;
- Manage Staff operational expense at a prudent level;
- Manage the System's Liquidity, in order to meet Member and other System obligations in a timely manner;
- Provide ongoing financial education to the Board and Staff in order for them to carry out their responsibilities; and
- Comply with all applicable laws and regulations applicable to the investment of the Portfolio.

# III. Role Definitions

The following sections outline the roles of the principal parties involved, their responsibilities and performance evaluation.

**Board of Trustees**

The Board is responsible for establishing the Policy for the System and overseeing the investment of the Portfolio and the expenditures required to meet System obligations. Specifically with regard to investments, the Board takes action based on information presented at Board and/or Investment Committee meetings and upon recommendations made by Staff or Consultants.

The Board maintains a long-term investment focus and has adopted a formal review schedule, as set forth in Appendix 2.

**Investment Committee**

The Investment Committee makes recommendations to the Board and supports the Board's deliberations on a broad range of issues covered by this Policy including, but not limited to, those set forth in this Investment Policy.

**Executive Director**

The Executive Director, in connection with such person's duties regarding this Investment Policy, shall be responsible for the following, among other things:

1. Execution of agreements and contracts, and amendments thereto, with Board-approved Managers, Consultants, Custodians and Vendors;
2. Ensuring that funds are invested in accordance with Board policies;
3. Communicating with the Board, its Officers and Investment Committee chair;
4. Studying, recommending, and implementing policy and operational procedures that will enhance the investment program of SURS;
5. Monitoring the performance of the Portfolio and the Staff; and
6. Ensuring that proper internal controls are developed to safeguard the assets of the System.

**Internal Investment Staff**

The internal investment staff ("**Staff**") provides internal investment management and/or consulting services to the Board and Investment Committee, implements Board decisions and manages the Portfolio, consistent with this Policy. Staff is expected to provide written recommendations to the Board and Investment Committee on investment related matters.

The Chief Investment Officer ("**CIO**") heads the Staff and oversees the performance of its members. The CIO reports to the Executive Director, but works directly with the Board and the Investment Committee on Policy-related issues.

The primary functions delegated by the Board to the CIO and the Staff may include, but are not limited to, working with the Executive Director and the Board to implement this Investment Policy and Board decisions made in connection with the Investment Policy. In connection therewith, Staff will be expected to manage cash-flow and liquidate assets, as necessary to pay benefits and other System obligations; to approve revisions to Manager Guidelines, with the approval of the Consultant and General Counsel; to serve on advisory boards where in the best interests of the System; to respond to inquiries relating to the Portfolio in accordance with SURS' communications policies; and to complete other administrative duties related to the operation of the Portfolio, not inconsistent with this Investment Policy.

**External Investment Consultants**

The Board may retain an investment advisor who is a paid, professional consultant ("**General Consultant**") and who is qualified to provide the Board with investment advice by academic and professional training and experience and is considered an expert in the field of investment and finance. The Board may also elect to retain one or more additional Consultants ("**Special Consultants**", and together with the General Consultant, the "Consultant") that specialize in specific areas of asset consulting. Each Consultant's relationship with the Board shall be that of a fiduciary under 40 ILCS 5/1-101.2(2).

Consultants are hired by, and report directly to, the Board. Their duties are to work with the Board, Investment Committee and its chair, and Staff in the management of the investment process. Consultants are expected to provide written recommendations to the Board and Investment Committee on investment related matters.

An annual review of each Consultant will be conducted by the Board, with input from the Staff.

**External Investment Managers**

External investment managers ("**Managers**") are selected by, and serve at the pleasure of, the Board. Staff implements the Board's decisions through negotiation, execution and enforcement of Investment Management Agreements, including Manager Guidelines. Staff works with Consultants to design Manager Guidelines specific to Board-approved assignments. Duties of Managers include, but may not be limited to, those set forth in Appendix 3. Each Manager's relationship with the Board shall be that of a fiduciary under 40 ILCS 5/1-101.2(2).

Criteria for selection, retention and termination of Managers are covered in Sections VII and VIII.

**Master Trustee / Custodian**

The Master Trustee/Custodian ("**Custodian**") is selected by, and serves at the pleasure of, the Board. The Custodian will, among other duties, collect income and keep safe all cash and securities, and will regularly summarize these holdings, along with both their individual and collective performance, for Staff's review. The Custodian will provide data and performance reports to the Staff and Consultants at requested intervals. In addition, a bank or trust depository arrangement will be utilized to accept and hold cash prior to allocating it to Managers and to invest such cash in liquid, short-term securities in accordance with Manager Guidelines. Pursuant to approved Strategic Policy Targets, Staff will direct the Custodian to allocate cash and/or securities to the System's Managers as necessary. The Custodian may also, with the approval of the Board and at the direction of the Staff, engage in a Securities Lending program. Alternatively, the Board may choose to retain a third party firm to provide Securities Lending services.

**General Counsel's Office**
The role of the General Counsel's office is to oversee internal and external legal services provided to the System in connection with this Policy and to ensure compliance with all applicable legal requirements.

**External Counsel**
External Counsel may be retained to provide legal services in connection with the review and negotiation of Investment Management Agreements or investment transactions where specialized experience is required or where General Counsel Office resources are unavailable. The Board also retains its own External Counsel, which solely represents the Board's interest in matters related to this Policy.

# IV. Strategic Allocation and Rebalancing Strategy

**A. Purpose**

The purpose of the Strategic Allocation and Rebalancing Strategy is to establish a framework that has a high likelihood, in the judgment of the Board, of realizing the System's long-term funding success.

**B. Targets and Ranges**

Strategic Allocation involves establishing Target Allocation Percentages for each approved Strategic Class and their sub-class components. Target Allocation Percentages are established and amended from time-to-time by the Board, based on recommendations from the General Consultant. Target Allocation Percentages are selected based upon a review of various combinations of Strategic Classes and their respective Components designed to sustain the System's funding progress while incurring an acceptable level of risk.

In developing its recommendation, the General Consultant takes into consideration Expected Returns, Volatility of Returns and Covariance of Returns, and certain scenario and Liquidity risks. SURS' current Strategic Policy Target and Interim Policy Target Percentages are set forth in Appendix 4.

The Interim Policy Target may change over time and reflects the necessity of a gradual shift of assets to the Strategic Policy Target, due to practical implementation considerations and Liquidity constraints. Staff has discretion to gradually adjust the Interim Policy Targets toward the Strategic Policy Targets.

**C. Rebalancing**

Investment returns on each Strategic Class in the portfolio (both positive and negative) cause the balance of each such Strategic Class to increase/decrease. Such changes cause the resultant Strategic Class Percentages to deviate from the Strategic Policy Target, potentially requiring Rebalancing.

Rebalancing shall automatically occur whenever a Strategic Class is three (3) percentage points greater or lesser than the Strategic Policy Target level or when the overall Broad Growth allocation deviates from the aggregate Broad Growth target by more than five (5) percentage points. Rebalancing may also be initiated by the Staff as part of its annual review or at any time when Strategic Class Percentages deviate significantly from Strategic or Interim Policy Targets, as applicable. Rebalancing may also occur in the event of a change in the Strategic Policy Target mix by the Board.

Rebalancing, when required, shall occur as soon as practical and may be facilitated by the use of a Cash Overlay Manager approved by the Board. In the event of extraordinary market events that (i) result in Strategic Class Percentages deviating significantly from Strategic Policy Targets or Interim Policy Targets, as applicable, but (ii) prevent the implementation of Rebalancing activities, Staff may request from the Board temporary exceptions to these guidelines.

Because certain Strategic Classes and sub-class Components are illiquid or less liquid than others, it may be costly or impractical to rebalance in the short term. Accordingly, qualitative considerations (e.g., transaction costs, liquidity needs, investment time horizons, etc.) will be considered in determining the potential timing and extent of Rebalancing to the extent illiquid/less liquid Strategic Classes/Components require adjustment.

The Target Allocation Percentages shall be established at a reasonable cost, recognizing that overly precise administration of policy targets can result in transaction costs that are not economically justified. Consequently, the Board accords the Staff discretion to take those actions which, in the judgment of the Staff, are within the spirit of these guidelines and in the best interest of SURS. Staff will report the results of Rebalancing activity to the Investment Committee at the next regular Investment Committee meeting.

**D. Periodic Review**

The Target Allocation Percentage will be reviewed annually for reasonableness relative to changes in the General Consultant's recommendation. The Board will undertake a comprehensive review of the Strategic Allocation policy every three to five years, or to the extent there are any significant changes made to the System's Strategic Objectives. This review will take into consideration the ongoing effectiveness of the Consultant's recommendation, an updated Asset/Liability Study, System Liquidity and other factors that may influence the Strategic Policy Target or Rebalancing strategies.

## V. Investment Risk Management

**Risk Oversight**
Investment risk shall be undertaken in order to achieve long-term investment objectives. The Board shall monitor investment risk and set guidelines for the Staff to manage such risk within acceptable tolerance levels.

**Portfolio Risk**
Risk levels within the Portfolio will evolve over time for various reasons, including (but not limited to) changes in: (i) Strategic Allocation; (ii) volatility in Strategic Class/Component returns; (iii) Strategic Class/Component relationships; and (iv) portfolio Liquidity.

**Other System Risks**
The System also incurs risks associated with: (i) amount and timing of Appropriation payments; (ii) the amount and timing of Member benefits and other System obligations; and (iii) changes in the System's Asset/Liability Position.

**Risk Monitoring**
Portfolio risk shall be monitored through multiple forms of analysis. Analysis will occur at various levels of detail, including individual Manager, Strategic Class and Total Portfolio.

For Marketable Securities' portfolios, individual Managers will be reviewed quarterly using risk measures that may include: (i) Beta (ii) Standard Deviation; (iii) Tracking Error and (iv) R-squared. For private markets, individual Managers will be periodically reviewed using risk measures tailored for each Asset Class.

For major Strategic Classes and their Components, the Board will review quarterly risk measures that may include Standard Deviation.

For the Portfolio as a whole, the Board will review on a quarterly basis various risk measures that may include: (i) Actual vs. Target Allocation Percentages; (ii) Total Portfolio Risk; (iii) market Volatility Index; (iv) Standard Deviation; (v) Value at Risk; (vi) actual vs. projected Sharpe Ratios; and (vii) Liquidity Profile.

Other system risk metrics may include: (i) System Cash Flow analysis and (ii) Asset/Liability gap analysis.

To the extent that risk thresholds at the individual Manager, Strategic Class or Portfolio level exceed those established by the Board, Staff will recommend remedial action for Board approval at the next scheduled Board Meeting.

**Reporting**
Reports will be assembled on a quarterly basis by Staff, Consultant or Custodian, as applicable and provided to the CIO for review. Summary reports will be assembled and presented to the Investment Committee and the Board on a quarterly basis.

## VI. Portfolio Construction and Performance Benchmarks

The Board has adopted Target Allocation Percentages in accordance with its Asset Allocation and Rebalancing strategy described in Section V. Within each Asset Class, the Board will determine the amount of such class that will be (i) managed internally vs. externally; (ii) managed actively vs. passively; (iii) allocated to a particular sector or style, if any, and (iv) allocated to each approved Manager. Asset Class allocations will be reviewed annually in connection with the Target Allocation Percentage review.

The choice of internal vs. external management shall be based on a periodic comparison of (i) the cost and availability of qualified Staff and systems support and (ii) the cost and availability of Managers. Currently, the Board makes exclusive use of external Managers.

Active Management shall be considered for Asset Classes and styles of Marketable Securities (actively traded public Equity, public Fixed-income and Alternative markets), where empirical evidence shows that (i) a significant percentage (e.g. 25%) of Managers in such category (adjusted for survivorship) have consistently outperformed applicable Benchmarks for such category (net of fees) over a three (3), five (5) and ten (10) year period and (ii) that outperformance has been significant (e.g. greater than 50 basis points). For categories not meeting this threshold, and subject to SURS' MFDB Manager Utilization Goals and Manager Diversity Program, Passive Management will be followed. For all non-actively traded public Equity, public Fixed-income and Alternative markets, Active Management will be used.

Amounts allocated to a particular sector or style shall also be based on empirical evidence showing that (i) a significant percentage (e.g. 25%) of Managers in such sub-sector or style (adjusted for survivorship) have consistently outperformed applicable Benchmarks for such sub-sector or style (net of fees) over a three (3), five (5) and ten (10) year period and (ii) that outperformance has been significant (e.g. greater than 50 basis points). If such threshold is not met, no allocation to such sub-sector or style will be made.

Amounts allocated to each Manager, within an Asset Class, sector or style shall be based on: (i) the total dollar amount to be allocated to such category; (ii) the relative ongoing performance of applicable Managers; (iii) the unique attributes of such Manager's investment style and potential benefits from diversification; and (iv) the overhead cost of managing the number of Managers within such category. Subject to SURS' MFDB Manager Utilization Goals and Manager Diversity Program, the Board has a bias toward fewer Managers and more meaningful allocations.

Managers selected by the Board will be given specific roles within each Asset Class, sub-sectors and styles, as applicable. These roles are specifically set forth for each firm as Manager Guidelines, established at the beginning of the relationship with SURS as part of the contract negotiation process. These guidelines cover such items as Benchmarks, permissible investments, use of leverage, obligor concentrations, currency denomination, etc. Staff and Consultant will be responsible for implementation of these guidelines, supervision of the Managers, performance monitoring and reporting. Updates will be provided to the Board or Investment Committee as requested, or as deemed necessary by Staff and Consultant.

**Public Equity Structure**

A. Role

The public Equity portfolio is expected to generate attractive absolute returns in a relatively low cost manner. The public Equity portfolio may also serve as a source of Liquidity.

B. Investment Structure

1. The public Equity allocation consists of a highly diversified mix of publicly traded global Equities. Common stocks, preferred stocks, or other Equity securities are typically utilized.
2. The public Equity portfolio is composed of U.S., non-U.S. and global Equity segments.
    - U.S. Equities
        - Managers invest primarily in publicly traded Equity securities of U.S. companies.
        - Certain Managers may utilize an exchange-traded, U.S. equity index options-based strategy.
    - Non-U.S. Equities
        - Managers invest primarily in publicly traded Equity securities of non-U.S. companies, in both developed and emerging markets.
    - Global Equities
        - Managers make the allocation decisions between U.S. and non-U.S. companies, in both developed and emerging markets.
3. Allocation
   The current policy targets for the subcomponents of the public Equity portfolio are set forth in Appendix 4.
4. Assets may be held in Commingled Funds or privately managed Separate Accounts.
5. Use of leverage will be controlled as appropriate in the Manager's Guidelines.
6. Implementation of the public Equity portfolio is via a combination of Active Management and Passive Management. Passive Management is currently most prevalent in U.S. public Equities, which is a highly efficient market, but is also employed significantly in the non-U.S. Equity portfolio. The global Equity portfolio is currently implemented entirely via Active Management.

C. Benchmarks and Performance Targets

Benchmarks and Performance Targets for subcomponents of the Equity portfolio are set forth in Appendix 5.

**Principal Protection Structure**

A. Role

The principal protection portfolio is expected to provide a modest absolute return, be an anchor to the overall portfolio and significant diversification to the total Portfolio due to low correlation with other Asset Classes. In addition, the principal protection portfolio is expected to provide capital preservation, a source of Liquidity, lower volatility and competitive returns relative to an appropriate performance Benchmark.

B. Investment Structure
   1. The principal protection allocation consists of a diversified mix of publicly traded Fixed Income securities, invested across multiple asset types.
      - Quality standards, such as credit, concentration, duration, liquidity, etc., will be specifically set forth in each Manager's Guidelines, as applicable. In the event a security no longer meets the quality standards referenced above, the Manager may continue to hold such security if it believes doing so is in the best interest of SURS. The Manager shall provide written justification of the action to Staff [and Consultant] as soon as practicable.
   2. The principal protection portfolio is composed largely of Treasuries, Agency backed mortgage securities, and other agency backed bonds.,
      - Mortagage Backed Securities - Agency
         - Managers invest primarily in Mortgage backed Securities (MBS) issued by the U.S. government agencies (Fannie Mae, Freddie Mac, or Ginnie Mae).
      - Treasuries
         - Managers invest in treasury securities of the U.S. government.
      - Other
         - Managers may invest in other high quality segments as clarified in manager specific guidelines, however these must be Investment Grade credit that is rated "BBB" or higher by two or more of the credit rating agencies
   3. Allocation
      - The policy targets for the subcomponents of the portfolio are set forth in Appendix 4.
   4. Assets may be held in Commingled Funds or privately managed Separate Accounts.
   5. Use of leverage and short sales will be controlled as appropriate in the Manager's Guidelines.
   6. Implementation of the Principal Protection portfolio is primarily via Active Management..

C. Benchmarks and Performance Targets
   Benchmarks and Performance Targets for subcomponents of the Fixed Income portfolio are set forth in Appendix 5.

**<u>Credit Structure</u>**

A. Role
   The public credit portfolio is expected to provide income, yield and diversification to the total Portfolio due to a moderate correlation with other Asset Classes. In addition, the public Credit portfolio is expected to provide return, a source of Liquidity, and positive returns relative to an appropriate performance Benchmark.

B. Investment Structure
   1. The Credit allocation consists of a diversified mix of publicly traded Credit securities, invested across multiple asset types.
      - Quality standards, such as credit, concentration, duration, liquidity, etc., will be specifically set forth in each Manager's Guidelines, as applicable. In the

event a security no longer meets the quality standards referenced above, the Manager may continue to hold such security if it believes doing so is in the best interest of SURS. The Manager shall provide written justification of the action to Staff [and Consultant] as soon as practicable.

2. The public credit portfolio is composed of Global Investment Grade, High Yield, Global Bank Loans and Emerging Market Debt ("**EMD**") segments.
    - Global Investment Grade
        - Managers may invest primarily in global investment grade securities of corporation and governmental agencies.
        - Global Investment Grade is defined as those with a rating of at least "BBB-" or equivalent by two or more of the credit rating agencies.
    - High Yield
        - Managers are permitted to invest in high yield bonds with an understanding that these bonds provide greater risk, potential for capital loss but with greater potential yield/return.
        - High Yield bonds are defined as those that are rated lower than "BBB-" by at least one of the credit rating agencies.
    - Global Bank Loans
        - Managers may invest in global bank loan debt
    - EMD
        - Managers invest in Investment Grade corporate and high yield debt securities of emerging market countries, in both U.S. dollar and local currency terms, providing additional diversification and opportunities for higher yield.
3. Allocation
    - The policy targets for the subcomponents of the portfolio are set forth in Appendix 4.
4. Assets may be held in Commingled Funds or privately managed Separate Accounts.
5. Use of leverage and short sales will be controlled as appropriate in the Manager's Guidelines.
6. Implementation of the Credit portfolio is via Active Management.

C. Benchmarks and Performance Targets
Benchmarks and Performance Targets for subcomponents of the Fixed Income portfolio are set forth in Appendix 5.

**Inflation Sensitive Structure**

A. Role
The Inflation Sensitive portfolio is expected to provide the portfolio with a hedge against structural and unanticipated inflation. In addition, the inflation sensitive portfolio is expected to provide competitive returns relative to an appropriate performance Benchmark.
    - Quality standards, such as credit, concentration, duration, liquidity, etc., will be specifically set forth in each Manager's Guidelines, as applicable. In the event a security no longer meets the quality standards referenced above, the Manager may continue to hold such security if it believes doing so is in the

best interest of SURS. The Manager shall provide written justification of the action to Staff [and Consultant] as soon as practicable.

B. Investment Structure

Treasury Inflation Protected Securities – **"TIPS"**

- The inflation sensitive allocation consists of Treasury Inflation Protection Securities ("**TIPS**").
- Implementation of the TIPS portfolio is currently via Passive Management.

Commodities

1. The Commodities portfolio consists primarily of liquid positions in Commodity Options, Futures, Swaps, and other financial instruments that provide direct or indirect exposure to Commodity markets. As collateral for the Commodity positions, cash, cash equivalents and other Fixed Income instruments may be held as required by exchanges or counterparties.
2. The Commodities portfolio is composed of Long-Only and Long/Short segments.
    - Long-Only
        - Long-only strategies manage Commodities through key value drivers, including term structure weighting, optimal roll yield, and tactical allocation among different sectors and individual commodities. Some long-only Managers pursue strategies that equalize risk among the four primary commodity complexes: precious metals, industrial metals, energy, and agriculture/livestock. Long-only strategies are expected to provide Beta exposure consistent with applicable Benchmarks.
    - Long/Short
        - Long/short Managers have an absolute return objective, whereby they can invest in both long and short commodities positions depending on market conditions. The Beta of long/short strategies tends to be quite low compared to the applicable Benchmark. Long/short Managers may invest in Commodities not typically represented in traditional Commodities' Benchmarks.
3. Diversification
   While the Commodities portfolio's positions are generally expected to be held across Commodity sectors, exposure to a particular Commodity sector (or to a particular Commodity within such sector) may be concentrated.
4. Within the portfolio, commitments have been made via a fund structure.
5. Leverage may be present in Commodities portfolios and is determined on a fund-level basis.
6. Implementation of the commodities portfolio is currently via Active Management.

C. Benchmarks and Performance Targets
Benchmarks and Performance Targets for the Commodities portfolio are set forth in Appendix 5.

**Private Equity Structure**

A. Role

The Private Equity portfolio is expected to earn Risk-Adjusted Returns in excess of the public Equity markets, primarily due to the Liquidity Premium demanded by investors. The Private Equity portfolio is also expected to decrease the volatility of the Portfolio, through the diversification benefits of having lower correlations with other Asset Classes.

B. Investment Structure

1. The Private Equity allocation generally consists of investments into private companies, either directly or through buyouts of public companies that result in a delisting of public Equity.
2. The Private Equity portfolio is composed of three major subcomponents.
    - Venture Capital/Growth
        - Venture capital partnerships primarily invest in businesses still in the conceptual stage (start-up or seed) or where products may not be fully developed, and where revenues and/or profits may be several years away.
        - Growth/later-stage venture capital partnerships typically invest in more mature companies in need of growth or expansion capital.
    - Buyout
        - These partnerships provide the equity capital for acquisition transactions either from a private seller or the public, which may represent the purchase of an entire company, or a refinancing or recapitalization transaction where Equity is purchased.
    - Other
        - Mezzanine/subordinated debt partnerships provide the intermediate capital between Equity and senior debt in a buyout or refinancing transaction.
        - Restructuring/distressed debt partnerships typically make new investments in financially or operationally troubled companies, often for a control position, with a view to improving the balance sheet and operations for a subsequent sale.
        - Special situations partnerships include organizations with a specific industry focus or transaction type not covered by the other subclasses mentioned above, or unique opportunities that fall outside such subclasses.
3. Allocation
    - The Private Equity portfolio shall be diversified by time, subclass, and geography.
    - Such diversification is expected to enhance returns, control risk, and reduce volatility.
4. The account structure is typically in funds. SURS currently participates through a Fund-of-Funds structure, which provides Manager diversification and the opportunity for co-investment and secondary fund opportunities.
5. Leverage may be present in Private Equity investments, most commonly in buyout partnerships. Levels are generally determined on a fund-level basis.
6. Implementation of the Private Equity portfolio is via Active Management.

C. Benchmarks and Performance Targets
   Benchmarks and Performance Targets for the Private Equity portfolio are set forth in Appendix 5.

**<u>Non-Core Real Asset Structure</u>**

A. Role
   The Non-Core Real Asset portfolio is expected to earn Risk-Adjusted Returns in excess of the public Equity markets, primarily due to re-positioning and development of real asset projects, the use of leverage, and to a Liquidity Premium demanded by investors. At the margin, the Non-Core Real Asset portfolio is also expected to diversify the broader Non-Traditional Growth Portfolio, which also includes Private Equity (see above).

B. Investment Structure
   1. Non-Core Real Asset investments provide access to opportunities for higher returns by investing (typically with the use of leverage) in assets in need of re-tenanting, development, re-development, operational improvements, or renovation, or are otherwise in some form of distress, exhibit sub-optimal capital structures, or experiencing market dislocation(s). They may also be located in emerging/non-institutional market segments and/or product/asset types. Such investment may utilize more aggressive financial structures in order to raise the return/risk profile, emphasize capital appreciation, and exhibit relatively high return objectives.
   2. The Non-Core Real Asset portfolio may consist of equity or debt investments in real estate, infrastructure, agriculture, energy-related investments, or timberland.
   3. Allocation
      - The Non-Core Real Asset portfolio shall be diversified by time, subclass, and geography.
      - Such diversification is expected to enhance returns, control risk, and reduce volatility.
   4. The account structure is typically in funds. SURS may also consider investments through a Fund-of-Funds structure, which provides Manager diversification and the opportunity for co-investment and secondary fund opportunities.
   5. Leverage is typically present in Non-Core Real Asset investments. Levels are generally determined on a fund-level basis.
   6. Implementation of the Non-Core Real Asset portfolio is via Active Management.

C. Benchmarks and Performance Targets
   Benchmarks and Performance Targets for the Non-Core Real Asset portfolio are set forth in Appendix 5.

**<u>Real Assets Structure</u>**

A. Role
   The Real Asset portfolio is expected to generate attractive Risk-Adjusted Returns through stable income and the opportunity for capital appreciation, while providing diversification to the overall Portfolio.

B. Investment Structure

1. The Real Asset allocation consists of Core Real Estate and Core/Core-Plus Infrastructure.

    - Core Real Estate
        - Core Real Estate Managers typically invest in properties that are well located and well leased with strong quality tenants. Core investments provide stable income with lower volatility.
    - Core Infrastructure
        - Funds typically invest in a variety of assets in the transportation, power/utilities, midstream energy, ports, communications, and waste management sectors globally. Core investments should exhibit low-to-moderate levels of leverage, both income and appreciation return orientation, emphasis on return/investment stability, etc.
    - Core-Plus Infrastructure
        - Funds typically invest in a variety of assets in the transportation, power/utilities, midstream energy, ports, communications, and waste management sectors, but may exhibit some level of sector-specific expertise or capability. Core-plus investments typically exhibit moderate levels of leverage, both income and appreciation return orientation, emphasis on return/investment stability, etc. Core-plus infrastructure may have modestly higher return expectations than core infrastructure.
2. Allocation
    - The minimum policy allocation for the Core Real Estate and Infrastructure subcomponents is 50% of Real Assets component.
3. The account structure for Core Real Estate and Infrastructure is typically either Open-end Funds or Closed-end Funds. SURS may also participate through Fund-of-Funds structures, which provide further Manager diversification and the opportunity for co-investment and secondary fund opportunities.
4. Leverage is an inherent component of Real Assets investing and levels are generally determined on a fund-level basis. Leverage levels in Real Assets are typically lower than those for Non-Core Real Assets.
5. The Real Assets portfolio is implemented via Active Management. SURS will seek to diversify the portfolio by utilizing various Managers and limiting a Manager’s concentration within the portfolio. Subject to Emerging Investment Manager and MFDB Utilization Goals and Board exception, concentration limits are set forth in Appendix 4. The optimal number of investment vehicles in the portfolio and their vintage year exposure varies with market opportunities and will be evaluated as part of the Real Assets Strategic Plan and Pacing Model developed by Staff and Consultants.

C. Benchmarks and Performance Targets

Benchmarks and Performance Targets for subcomponents of the Real Assets portfolio are set forth in Appendix 5.

**Opportunity Fund**

A. Role

The Opportunity Fund portfolio is designed to allow flexibility for opportunistic investment. Investments in the Opportunity Fund may be a one-time occurrence, such as investments capitalizing on a market dislocation. Successful investments that evolve into a more permanent opportunity may ultimately be transitioned into another Asset Class with similar characteristics.

B. Investment Structure

The structure of the Opportunity Fund is not fixed and may vary considerably over time.

C. Benchmark

Benchmarks and Performance Targets for the Opportunity Fund portfolio are set forth in Appendix 5.

**Hedged Strategies**

A. Role

The Hedged Strategies portfolio is expected to provide stable, Risk-Adjusted Returns. Hedged Strategies attempt to (i) generate above-market returns or (ii) to offer downside protection and risk mitigation to the overall SURS Portfolio, through diversification with lower correlations with other Asset Classes.

B. Investment Structure

1. SURS has implemented its initial Hedged Strategies through a Fund-of-Funds structure.
2. The Fund-of-Funds portfolio shall consist of investments, by one or more Hedge Fund-of-Fund Managers, in a select group of experienced Hedge Fund Managers that (i) pursue a variety of strategies and (ii) invest in a variety of markets, through limited partnerships, limited liability companies and other investment entities.
3. Hedge Fund-of-Funds Managers typically invest in Hedge Funds pursuing one or more of the following strategies: convertible bond hedging; Fixed Income relative value; distressed debt; long/short credit; event driven Equities; Equity market neutral; long/short Equity; emerging markets; global macro; managed Futures and Options; niche strategies and opportunistic sectors, among others.
4. The Hedged Strategies portfolio will seek to invest globally across Asset Classes and will be diversified by underlying Hedge Fund Managers and sectors.
5. Within the portfolio, the account structure is typically in funds.
6. Leverage is not typically employed at the Fund-of-Funds level, but may be employed to varying degrees at the Hedge Fund level.
7. Implementation of the Hedged Strategies portfolio is via Active Management.

C. Benchmarks and Performance Targets

Benchmarks and Performance Targets for the Hedged Strategies portfolio are set forth in Appendix 5.

**Options Strategies**

A. Role

The Options Strategies portfolio is expected to provide similar, but higher Risk-Adjusted Returns than public equity. This expectation should be due to these strategies (i) producing compound returns that are modestly below traditional long-only public equities over a full investment cycle while (ii) also incurring significantly lower volatility than long-only public equity. In addition, Options Strategies produce a return pattern that is significantly different from traditional public equity over time – specifically, periodic outlying returns should be reduced. In summary, Options Strategies are utilized to achieve downside protection and risk mitigation to the overall SURS Portfolio (and, in particular the traditional public equity portfolio).

B. Investment Structure

1. SURS has implemented its initial Options Strategies through direct allocations to multiple managers that exhibit specific expertise in this strategy.
2. The aggregate Options Strategies portfolio consists of managers that apply a limited range of collateral-supported options selling programs (i.e., (i) writing call options associated with a specified long position in an equity index fund or long positions of specified equity securities or (ii) writing index put options associated with a commensurate level of cash or very-near-cash collateral).
3. The Options Strategies portfolio may seek to invest globally across U.S. and non-U.S. markets, replicating the general risk characteristics of industry-standard equity market indices.
4. Within the portfolio, the account structure utilized may be a blend of separate account(s) and fund(s), depending on the assigned strategy/mandate.
5. Leverage is not typically employed in Options Strategies. Any degree of leverage requires SURS Board approval.
6. Implementation of the Options Strategies portfolio is via Active Management.

C. Benchmarks and Performance Targets

Benchmarks and Performance Targets for the Hedged Strategies portfolio are set forth in Appendix 5.

**Crisis Risk Offset Structure**

A. Role

The Crisis Risk Offset (CRO) portfolio is expected to produce significant positive returns during an extended recessionary-type equity market crisis, while maintaining purchasing power during more normal market environments. In this respect, the CRO portfolio is expected to enhance the long-term risk-adjusted performance of the Total Portfolio, by substantially mitigating significant drawdowns that the Total Portfolio might experience.

B. Investment Structure

1. The CRO allocation generally consists of investments in highly-liquid portfolios that are meant to capture key risk premia that should prove largely beneficial during an equity-related market crisis. Along these lines, the underlying investments and strategies may utilize both long positions and short-selling positions to capture the desired return patterns/behavior.

2. The CRO portfolio is composed of three major subcomponents.
    a. Long U.S. Treasury Duration
        i. U.S.Treasuries represent the leading "flight-to-quality" investment since they are backed by the U.S. Government. The U.S. Dollar (the base denomination of U.S. Treasuries) is also considered the world's highest-quality reserve currency.
        ii. Exposure to U.S. Treasury Duration can take place via cash markets (i.e., actual bonds) or the futures markets (virtual bond proxies).
    b. Systematic Trend Following
        i. Long-short portfolios utilizing derivatives-based instruments to capture both periodic appreciation and periodic depreciation trends that evolve and dissipate across a very wide array of liquid global markets. Risk/volatility is calibrated to a pre-determined level derivatives-based leverage.
        ii. Assets will be invested in highly liquid underlying securities (cash, futures, forwards, etc.), allowing for relatively rapid access for rebalancing and liquidity purposes.
        iii. In order to appropriately calibrate the expected volatility of this component and the overall CRO class, significant levels of derivatives-based leverage may be applied. Effects of leverage are adjusted daily through market-based exchanges/facilities, ensuring appropriate and timely mark-to-market valuations.
    c. Alternative Risk Premia
        i. Long-short portfolios utilizing both cash and derivatives-based instruments to capture well-researched/documented non-market risk premiums (e.g., momentum, carry, value, low-volatility, etc.) on a continuous basis, utilizing an array of liquid global markets. Risk/volatility is calibrated to a pre-determined level utilizing cash and derivatives-based leverage.
        ii. Assets will be invested in highly liquid underlying securities (cash, stocks, futures, forwards, etc.), allowing for relatively rapid access for rebalancing and liquidity purposes.
        iii. Strategies should be designed to exhibit "market-neutral" outcomes, exhibiting lack of relationship with the major market-based risk premia (e.g., equity risk premia, duration risk premia).
3. Allocation to Subcomponents
    a. Capital allocation ranges to the various subcomponents will be as follows:
        i. 30%-40% - Long Duration
        ii. 30%-40% - Systematic Trend Following (STF)
        iii. 25%-35% - Alternative Risk Premia (ARP)
    b. Assuming the capital weights above are consistently maintained, it is highly likely that the volatility associated with the Systematic Trend Following component will contribute the most to overall CRO class volatility over time.
4. Fund account structures (versus separate accounts) will be emphasized in the STF and ARP subcomponents. Use of fund account structures will likely reduce the monitoring, accounting, and administrative burdens of these relatively unconstrained and dynamic strategies.

5. Derivatives-based leverage will be utilized significantly across these strategies. Leveraged positions are typically adjusted on a daily basis to conform to pre-established guidelines (see below).
6. Implementation of the CRO portfolio will utilize both replication (passive) and active management where deemed appropriate and prudent within each subcomponent.

C. Risk Profile of CRO Class and its Subcomponents

a. The aggregate CRO class has a total risk (standard deviation) range/budget set at a level to effectively counterbalance the volatility experienced in the SURS portfolio's major growth-oriented components:

i. Lower risk level limit (annualized standard deviation): 8%
ii. Upper risk level limit (annualized standard deviation): 15%

If the behavior of the CRO class causes its recent historical volatility to deviate significantly beyond these limits, then a rebalancing process and/or target volatility adjustment should occur among the CRO managers based on recent risk profiles of each manager/component as well as on prospective risk views for each manager/component.

2. The expected volatility ranges for the three components are shown below:

**Risk Budget Ranges – CRO Components (% of Net Asset Value)**

| Component | Annualized Volatility Expectation |
|---|---|
| Long Duration Capture | 12% - 20% |
| Systematic Trend Following | 10% - 20% |
| Alternative Risk Premia | 8% - 15% |

While the expected volatility ranges for each subcomponent are high relative to the expected risk budget level of the aggregate CRO class, the diversifiying aspects of each subcomponent (and its underlying manager(s)) will combine to reduce volatility at the aggregate class level.

D. Benchmarks and Performance Targets

Benchmarks and Performance Targets for the CRO portfolio are set forth in Appendix 5.

# VII. Selection and Retention

**<u>Introduction</u>**
The processes used for selection and hiring of Consultants, Managers and Custodians are set forth in the ***SURS Investment Procurement Policy***. Monitoring of investment managers and fund investments will take place as described in this section.

**<u>Investment Manager and Fund Monitoring</u>**

**<u>Marketable Securities Portfolios</u>**
An evaluation of each Manager shall be conducted annually by the Staff and the Consultants. The evaluation shall be based on a number of factors, including, but not limited to, organizational and personnel issues and whether the Manager has met its Manager Guidelines, including its Performance Target. Evaluation will include the results of periodic due diligence meetings and phone calls. Documenting the annual evaluation, Staff and Consultants shall issue Manager Evaluation Reports. Reports shall include a recommendation to: (i) retain the Manager; (ii) retain or change the Manager's funding allocation; or (iii) terminate the Manager (see Section VIII, 'Investment Manager Termination Guidelines.' Managers will be assigned a status of Good Standing, Enhanced Review, or Reassessment, in accordance with the 'Manager Status' section below.

Between annual reviews, a Manager's status may change or, subject to Manager Termination Guidelines, the Staff or Consultants may recommend immediate Termination.

**<u>Closed-end Fund and Separate Account Evaluation</u>**
Limited partnership interests in private Closed-end Funds and investments in private markets Separate Accounts (i.e., Private Equity, Real Estate, infrastructure, etc.) will be reviewed by Staff and Consultant annually. The evaluation shall be based on a number of factors, including, but not limited to, organizational and personnel issues and whether the Manager has met its Manager Guidelines and Performance Target. Evaluation will include the results of periodic due diligence meetings and phone calls. Documenting the annual evaluation, Staff and Consultant(s) shall issue Manager Evaluation Reports. Reports will include a recommendation to: (i) retain the Manager; (ii) make follow-on investments or investments in subsequent Closed-end Funds or Separate Accounts, in accordance with the ***SURS Investment Procurement Policy***; or (iii) subject to legal review, pursue available exit strategies.

To the extent that significant concerns about a Closed-end Fund or Separate Account or material events arise in the interim, the Staff or Consultant shall communicate their concerns to the Investment Committee/Board and recommend available options, including exit strategies.

**<u>Manager Status</u>**
Managers of marketable securities portfolios will be categorized in one of three ways based on investment performance. Such analysis will take place semi-annually.

- <u>Good Standing:</u> A Manager's three (3) year and five (5) year rolling Annualized Alpha (net of fees) each exceed their Active Manager Premiums (AMPs) for such periods. Managers with less than a five (5) year performance history will be considered in Good Standing.

- Enhanced Review: A Manager's three (3) year or five (5) year rolling Annualized Alphas (net of fees) are above their respective Benchmarks but below their AMPs.
- Reassessment: A Manager's (i) three (3) year and five (5) year rolling Annualized Alphas (net of fees) are below their respective Benchmarks for the preceding two consecutive quarters, and (ii) three (3) year and five (5) year Information Ratios are negative for the preceding two consecutive quarters; or other performance metrics reflect a significant negative trend.

  Reassessment status may also be assigned to Managers that are not meeting the requirements of their Manager Guidelines including, but not limited to, the following:

- Change in ownership, organizational structure or key personnel;
- Lack of compliance with MFDB brokerage goals;
- Significant loss of clients or assets under management or failure to grow assets in the strategy; or
- Significant change in investment style, philosophy or process.

A Manager's status may change to the extent that the Board believes that acceptable remedial actions have been taken, performance has improved to warrant such a change, or upon Termination.

# VIII. Investment Manager Termination Guidelines

**Introduction**

From time to time it will be necessary for the System to terminate a contractual relationship with a Manager. Pursuant to its fiduciary duties, the Board has established the following guidelines to assist in making these Termination decisions. In establishing these guidelines, it is the Board's intention to carry out these actions using objective evaluation, proper documentation and full disclosure. The overriding consideration with respect to all decisions is that they shall be made solely in the best interest of Members and consistent with all legal requirements.

**Clearly Defined Objectives**

Any action to terminate a Manager should be based on one or more of the following primary criteria:

- A Manager on Reassessment status has been unable to remediate concerns to the Board's satisfaction;
- At a semiannual review for a Manager of Marketable Securities, such Manager's (i) three (3) year and five (5) year rolling Annualized Alphas (net of fees) are below their AMPs for the preceding four (4) consecutive quarters, (ii) three (3) year and five (5) year rolling Information Ratios are negative for the preceding four (4) consecutive quarters and (iii) other Investment Statistics fail to reflect any reversal in trend;
- Any other guideline is violated by a Manager and is not remediated to the satisfaction of the Board;
- Default under an Investment Management Agreement;
- Change in Asset Allocation, which reduces or eliminates the need for all existing Managers; or
- Failure to satisfy any other legal or Policy requirements.

Prior to a Termination decision, a thorough evaluation of the relevant criteria supporting such action shall be reviewed by the Board. Documentation regarding any such action shall include the reasons for such decision.

In the event that termination of a Manager is warranted under the Manager Termination Guidelines, and prompt termination of the Manager is necessary to protect and preserve System assets, SURS Staff may, with the prior approval of the Executive Director, terminate the Manager prior to Board action. The Board shall be promptly notified of the decision to terminate the Manager and the decision shall be presented to the Board for ratification at its next meeting.

Notwithstanding this provision, the Board retains the authority, in its sole discretion, to terminate any Manager for any reason, with or without notice, when it determines such action is in the best interests of the Members.

**Investment Manager Transition**

In the event of the need to transfer the management of assets from one Manager to another, Staff will effect the change in as efficient and prudent a manner as possible. The use of Transition Manager(s), which could include the use of a Cash Overlay Manager or Rebalancing Manager, is permitted when deemed in the best interests of the System. Transition plans may include, but are not limited to, the following: a transfer of securities to an appropriate Passive Investment, crossing securities with other institutional investors, or a transfer of securities to another approved Manager.

# IX. Performance Evaluation and Reporting

## Performance Evaluation

Marketable Securities Portfolios
Rates of Return and Risk-Adjusted Returns, on a net-of-fees basis, shall be calculated quarterly by the Custodian or Consultants to measure the performance of each major Asset Class. Actual Trailing Period returns for fiscal year-to-date, one (1) year, three (3) year, five (5) year, ten (10) year periods will be compared to comparable returns for applicable Policy Portfolio indices.

Rates of Return and Risk-Adjusted Returns, on a net-of-fees basis, shall also be calculated quarterly by the Custodian or Consultants to measure the performance of each individual Manager. Actual (i) Trailing Period returns for one (1) year, three (3) year, five (5) year, ten (10) year periods and from inception and fiscal year-to-date and rolling three (3) year returns for the previous four (4) quarters, will be compared to comparable Performance Targets, to determine Excess Returns and Excess Risk-Adjusted Returns.

For individual Managers, a number of other performance measures shall be calculated quarterly. These may include such items as peer group performance, Risk Statistics and Performance Statistics.

Private Markets Portfolios
For Private Equity, Direct Real Estate and Infrastructure portfolios, Internal Rates of Return shall be calculated quarterly by the Custodian. These returns will be used to measure performance of the portfolios in comparison with Policy Portfolio indices and Performance Targets for Asset Classes and individual Managers. Returns are calculated quarterly in arrears. Other more tailored performance measures may also be used for absolute and peer group comparisons.

Total Portfolio
Actual returns for the total Portfolio are compared to returns on the Policy Portfolio. Returns are calculated quarterly by the Custodian.

Style Analysis
Staff and Consultants will periodically analyze Manager portfolios, as well as the aggregate Strategic Class and Component portfolios, to confirm that such portfolios conform to individual Manager style Benchmarks and aggregate Strategic Class and Component indices. Metrics such as Active Share will be used in this analysis. Significant deviations shall cause individual Managers to be placed on Reassessment status and, if not remediated, shall lead to Termination.

## Performance Reporting

Performance reports shall be prepared by the Staff quarterly and provided to the Investment Committee and Board at regularly scheduled meetings.

Consultants will analyze the system's performance and periodically provide the Board with a detailed report on the total Portfolio, Strategic Classes and individual Managers.

Annually, Staff and Consultants will prepare and present a comprehensive review of the fiscal year results.

**Market Values**

All assets in the Portfolio will be Marked-to-Market at least quarterly, to provide an estimate of the price at which .they could be sold. Following is a description of this process.

Marketable Securities

The Custodian provides price indications for stocks, bonds, warrants, futures, options, etc. traded on public exchanges.

Private or Illiquid Securities

For private and illiquid securities, each individual Manager or Fund-of-Funds Manager has the responsibility for estimating and publishing the market value of these investments. The valuation and appraisal methods used should be consistent with current CFA Institute and industry standards.

## X. Safeguard of Assets

- Qualification of Service Providers

  Any firm which SURS retains to manage, control or have custody of assets shall be and shall remain qualified by thorough on-going due diligence. Appropriate agreements with the firms and trust agreements shall minimize any risk of loss of assets or income.

- Asset Limits

  There are cost and service advantages in firms managing or having custody of large pools of assets so that in the absence of any statutory provision(s) to the contrary, there shall be no specific limit on the size of assets controlled or held in custody by any one firm within the asset allocation guidelines. However, limits may be considered on an individual Manager basis and will reflect such issues as type of mandate, strength and stability of organization, risk characteristics, etc.

- Monitoring of Service Providers

  There shall be continuous monitoring of firms which manage or have custody of assets to assure the firms continue to be stable and financially secure. Instability of any firm or financial weakness shall be reason to transfer custody and/or management of assets from the firm.

- Authorization to Transfer Funds

  Transfer of funds between accounts must be evidenced in writing or conducted electronically by an authorized Staff member and be in compliance with the Custodial bank's procedures. The following positions have been designated by the Board to have the authority to give direction to the Custodian on any and all actions with respect to the Master Trustee relationship between the Board and the Custodian: Executive Director, CIO, and deputy CIO. The senior investment officers have been designated by the Board to have the limited authority to approve payments initiated through the Trade Order Entry System related to initial or subsequent investments in limited partnerships, real estate, infrastructure, or other investments approved by the Board.

- Insurance Requirements

  Managers shall be required to secure and maintain, throughout the term of their Investment Management Agreements, insurance that (i) satisfies the requirements set forth below and (ii) is provided by insurer(s) rated A- or better by A.M. Best & Company. Specific insurance requirements are set forth in each Manager's Investment Management Agreement. Each Manager shall be required to provide to the Board: (i) evidence of the requisite insurance policies upon initiation of the contract; (ii) an annual certification that the insurance requirements continue to be satisfied; and (iii) evidence of continued satisfaction of the insurance requirements upon request. With the exception of the Manager Diversity Program, the minimum insurance required for each Manager shall include: (i) a bond protecting SURS assets that meets the requirements of, and that is in the amount specified under, ERISA and the regulations thereunder; and (ii) errors and omissions coverage in an amount equal to the greater of: a) $5 million or, b) 5% of the SURS assets under management, up to a maximum as established in the Investment Management Agreement, but not to exceed $50 million. For Managers in the Manager Diversity Program, the minimum insurance required for each Manager shall include: (i) a bond protecting SURS assets that meets the requirements of, and that is in the amount specified under, ERISA and the regulations thereunder; and (ii) errors and omissions coverage in an amount not less than $1 million of coverage. The insurance shall protect SURS against losses from the negligent acts, errors or omissions of the Manager.

- <u>Custodial Credit Risk</u>

  Pursuant to the 40 ILCS 5/15-166, the Board has statutory authority to be the custodian of all cash and securities belonging to the System created under Article 15 of the Pension Code. Pursuant to 40 ILCS 5/15-167, the Board may deposit SURS trust funds with one or more banks, savings and loan associations, or trust companies. This policy addresses how SURS will handle custodial credit risk.

  Credit risk is the risk that an issuer or other counter-party to an investment transaction will not fulfill its obligations. Custodial credit risk is the risk that, in the event of the failure of a financial institution or counter-party to a transaction, SURS would not be able to recover the value of deposits or investments in the possession of such party. To minimize this risk, SURS takes the following measures:

  1. Performs due diligence on Custodians and advisors with which SURS will do business and appropriately documents business relationships with these service providers.
  2. Provides investment parameters for the investment vehicles detailed in the specific Investment Management Agreements.
  3. Monitors the financial condition of the Custodian. If there is cause for concern, the Board of Trustees will determine appropriate action.
  4. Endeavors to have all investments held in custodial accounts through an agent, in the name of Custodian's nominee[1], or in a corporate depository or federal book-entry system. For those deposits or investment assets held outside of the Custodian, SURS will follow applicable regulatory rules.
  5. Requires the Custodian or its sub-Custodians will provide safekeeping of all SURS securities in segregated accounts that reflect the holdings of SURS; and the Custodian will not commingle SURS securities with the Custodian's own securities.

[1] Registered owner of a stock or bond if different from the beneficial owner, who acts as holder of record for securities and other assets. Nominee ownership simplifies the registration and transfer of securities.

# XI. General Investment Restrictions and/or Guidelines

- Investment Authorization

  No investment or action pursuant to an investment may be taken unless permitted by this Policy or by each Investment Manager's Guidelines. Exceptions may be made subject to prior review by, and express written authorization from, the Board.

# XII. Corporate Governance

## A. Proxy Voting Guidelines

The Board may retain a proxy voting service, pursuant to a contract with SURS, to vote the proxies of U.S. and non-U.S. shares according to the proxy voting service's proxy voting guidelines, as customized for SURS and approved by the Board. All proxy votes not specifically addressed by the proxy voting service's approved proxy voting guidelines, or if the Board determines not to retain a proxy voting service, will be voted on a case-by-case basis by Managers, subject to Staff review and consistent with the fiduciary responsibilities of the Board.

Guidelines will be reviewed annually by Staff in conjunction with the proxy service provider, and recommended changes to the guidelines will be presented to the Board for approval.

The 2017 SURS U.S. Proxy Voting Guidelines, SURS Public Pension Addendum, and the SURS International Proxy Voting Guidelines were approved by the Board and will be maintained on the SURS website.

## B. Proxy Voting Reports

The proxy voting service provider shall make regular reports of proxy votes cast on behalf of SURS and, on an ad hoc basis as requested by Staff or the Board, pursuant to the terms of the proxy voting contract with SURS.

## C. Securities Litigation Policy

### 1) Identification Of Potential Claims

a) In order to weigh the costs and benefits of the various alternatives as specified below, Staff will identify potential claims by determining if it bought or sold the securities of a company during applicable periods.

b) Staff will regularly match the SURS portfolios against reports of securities litigation cases obtained from Consultants, law firms engaged for securities litigation, and from other sources deemed reliable by Staff.

c) If SURS did not buy or sell securities of a company during the applicable period, the inquiry will end. If SURS had purchases or sales during the period, evaluation of the potential claim will proceed as specified below.

### 2) Evaluation Of Potential Claims

a) If SURS bought or sold securities during an applicable period, evaluation of the alternatives available will begin with an initial assessment of the size of the potential claim.

b) When potential losses are deemed insignificant, further action will ordinarily be limited to monitoring as specified in Part 3 below to ensure that class member claims are filed if and when there is a right to do so, unless there are extenuating circumstances that warrant further consideration by Staff and the Board.

c) When potential losses are deemed significant, the alternative courses of action available shall be identified by the Staff. Alternatives will likely include several different courses of action, such as:

   i) Monitoring the course of a class action suit and filing a claim at the end to participate in a class payment.
   ii) After consultation with the Illinois Attorney General's office, monitoring the course of a class action suit, but objecting to a proposed settlement if there are reasons to object.
   iii) After consultation with the Illinois Attorney General's office, seeking to control a class action by seeking designation as lead plaintiff, either singly or with others.
   iv) After consultation with the Illinois Attorney General's office, opting out of a class action suit and filing a separate suit, either singly or with others.

d) The relative merits of each alternative will be weighed and considered by Staff, as well as by the Illinois Attorney General's Office.

e) Staff and the Illinois Attorney General's office will make a recommendation to the Executive Committee or to the Board of any course of action beyond participating in the litigation as a passive member of the class. The Executive Committee, or the Board, as applicable, will have the authority to approve any course of action beyond monitoring the case. If the Executive Committee, or the Board, approves active participation in the litigation, additional authorization is not necessary to align with other potential plaintiffs in application for named plaintiff status if such an action is agreed appropriate by the General Counsel and the Executive Director. Counsel will be selected by the Executive Committee or the Board, after consultation with the Illinois Attorney General's office.

**3) <u>Monitoring</u>**

a) The Staff will utilize the services of the System's Custodian, as well as the services of any consultants, including Securities Litigation counsel, with expertise in this area chosen by the Board, to monitor pending cases which involve securities that SURS bought and sold during the relevant periods to evaluate any settlements proposed and to file claims as necessary for SURS to participate in distributions of funds. To the extent that Staff finds a proposed settlement inadequate to protect the interests of the System, the Executive Committee may authorize action to file legal objections. Authorization is not necessary for Staff to file an objection to attorneys' fees or expenses if an objection is agreed appropriate by the General Counsel and the Executive Director after consultation with the Illinois Attorney General's office.

**4) <u>Legal Action</u>**

a) Where the Executive Committee or the Board has determined under Part 2 that the interests of the System will be best served by seeking designation as lead plaintiff or by opting out of a class action, , will choose appropriate counsel and will negotiate a fee agreement, if necessary, after consultation with the Illinois Attorney General's office as to whether that office would be willing to serve as the System's counsel in such action. If the Executive Committee determines that appropriate counsel is a firm not on SURS' approved list, the recommendation of such firm shall be made to, and approved by, the Executive Committee.

b) Where the Executive Committee and the Illinois Attorney General's office disagree as to the desirability of seeking designation as lead plaintiff or opting out of a class action, the Executive Committee shall act in accordance with its fiduciary obligations in making a final determination.

c) Any legal action authorized or taken shall be reported to the Board, who shall also be provided periodic updates on the status of such actions.

**5) Approved Law Firms**

a) The Board, or Staff at the Board's direction, will interview and select, through an RFP, a roster of no more than three qualified securities litigation firms. This roster will constitute SURS' "approved list."

b) In cases where the initiation of litigation is a formality designed to provide support for another institutional investor, Staff may recommend that the most sensible and cost-effective source of legal representation will be the General Counsel or the legal counsel representing the institutional investor that SURS wishes to support.

**6) Authority to Settle Claims and Lawsuits**

a) Staff has the authority to resolve securities related litigation claims with a settlement value of $250,000.00 or less, with required approval from the Executive Director and General Counsel. This authority includes the ability to settle direct claims and class actions at or below the $250,000.00 threshold. This authority also includes the ability to resolve said claims by selling them to third parties or by resolving them via auction with a minimum return/guarantee of at least 50% of the potential value of the underlying claim. If SURS wants to settle a direct securities litigation case at a settlement value exceeding $250,000.00 or wants to settle a class action where SURS is the lead plaintiff, authority to settle must come from the SURS Executive Committee or the Board.

## XIII. Emerging Investment Managers, MFDB Managers and Minority-Owned Broker/Dealers

SURS is committed to providing opportunities for Emerging Investment Managers and Minority Owned Broker/Dealers. SURS is also committed to providing ongoing opportunities for minority-, female-, and persons with a disability-owned ("**MFDB**") Managers that have advanced beyond the statutory definition of Emerging Investment Managers. In determining the status of a business enterprise, SURS will use the definitions found in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act, 30 ILCS 575/2(A), (B).

The Illinois Pension Code, in 40 ILCS 5/1-109.1, encourages the Board to use Emerging Investment Managers in managing the System's assets to the greatest extent feasible within the bounds of financial and fiduciary prudence, and to take affirmative steps to remove any barriers to the full participation of Emerging Investment Managers in investment opportunities afforded by the System. Furthermore, in accordance with the Illinois Pension Code, SURS encourages its Fund-of-Fund Managers to use Emerging Investment Managers as subcontractors when the opportunity arises.

### A. Goals for Utilization of Emerging Investment Managers and MFDB Managers

Beginning January 1, 2016, the Illinois Pension Code, in 40 ILCS 5/1-109.1, established aspirational goals of 20% for pension funds, with respect to assets under management by Emerging Investment Managers and the percentage number of MFDB Managers.

Since late 2014, the Board (subject to its fiduciary responsibility) has established goals for both the percent of assets under management and actively managed assets under management by Emerging Investment Managers. Furthermore, with the intent of having MFDB Managers significantly represented in each broad Asset Class and not concentrated in any particular Asset Class, the Board has established additional goals for actively managed assets specific to Minorities, Females, and Persons with Disabilities.

A summary of the Board's goals are set forth in Appendix 6. These goals shall be reviewed annually.

### B. Goals for Utilization of Minority-Owned Broker/Dealers

The Board has set minimum expectations for the use of qualified Broker/Dealers that meet the definition of a minority-owned business, female-owned business or a business owned by a person with a disability ("**Minority-owned Broker/Dealer**") by the System's Managers. Only trades executed directly with Minority-owned Broker/Dealers will be considered in the achievement of these goals.

Summary goals for Minority-owned Broker/Dealer Utilization have been established for the aggregate U.S. equity, Non-U.S. Equity and Fixed Income Asset Classes as set forth in Appendix 7. SURS seeks to have its Managers consistently meet or exceed these goals, while achieving best execution.

In order to achieve the aggregate U.S. Equity, Non-U.S. Equity and Fixed Income goals, minimum expectations have been established for individual Managers within a number of Sub-Asset Classes. Subject to best execution, SURS requires its Managers to meet the minimum expectations set forth in Appendix 8 for each rolling twelve (12) month period.

**Reporting Guidelines**
Each Manager will submit a compliance report within 30 days after March 31, June 30, September 30 and December 31 of each year. Reporting will be monitored over a rolling twelve-month period.

**Consequences of Non-Compliance**
Failure to meet Minority-owned Broker/Dealer Utilization Goals will lead to the following:

1) Staff notification to the non-compliant Manager;
2) Placement of the Manager on Reassessment status;
3) Staff examination of reasons for non-compliance; and
4) Remediation plan acceptable to the Staff or recommendation to the Board to Terminate.

### C. <u>Manager Diversity Program</u>

Program Description

SURS has implemented a Manager Diversity Program ("**<u>MDP</u>**") to identify highly successful MFDB firms. The process used for selection of investment managers is set forth in the ***SURS Investment Procurement Policy***. Manager Benchmarks are identified in the Manager Guidelines for each Manager in the program. Benchmarks and Performance Targets for the MDP for each applicable Asset Class are the same as those set forth in the applicable Appendix. Managers in the MDP will be evaluated in the same manner as that set forth in Section VII ('Selection and Retention'). Managers will be placed on Reassessment status as described in Section VII. Termination decisions will follow the guidelines set forth in Section VIII ('Investment Manager Termination Guidelines'). An evaluation of each Manager shall be conducted annually.

### D. <u>Manager-of-Managers Program</u>

**Program Description**

SURS utilizes a Manager-of-Managers program, overseen by SURS Staff. The program's primary goal is to identify MFDB Managers that will be initially awarded smaller allocations within the program. Staff may recommend, for the Board's approval, one or more Manager-of-Managers to play an active role in identifying emerging MFDB Managers and maintain an ongoing involvement in the evaluation and performance oversight of such Managers. Staff shall work with the Manager-of-Managers to identify, recruit, and monitor Managers in the program.

**Graduation Program**

On an annual basis, SURS Staff and the Manager-of-Managers will identify one underlying Manager to be considered for a meaningful, direct allocation. The following factors are considered in determining when an underlying Manager should be awarded a larger allocation in the SURS Portfolio:

- Acceptable measure of performance over a three year period;
- Stability in Manager's organization;
- Institutional quality infrastructure;
- Growth in Assets Under Management;
- Confidence in Manager's investment process;
- Meeting its Performance Target; and
- Product Fit.

In addition to the factors mentioned above, the needs of the overall SURS investment program will be considered.

Notwithstanding this provision, the Board, in its sole discretion, may decide not to make any award in any given year, if it determines that such an allocation would not be in the best interests of the Members.

Initially adopted December 8, 2006; Revised April 26, 2007; September 21, 2007; September 12, 2008; April 23, 2009; September 11, 2009; December 2, 2009; September 3, 2010; September 16, 2011; October 25, 2012; September 13, 2013, September 19, 2014; September 11, 2015; December 9, 2016; June 9, 2017; December 8, 2017; March 9, 2018; April 18, 2019; June 7, 2019

# Exhibit I
# Glossary of Terms

**Active Management** means the style of fund management whereby Managers attempt to outperform a given Benchmark or Performance Target, after fees, through superior security or sector selection, market timing, technical modeling or other active technique.

**Active Manager Premium** or AMP means a percentage spread above an applicable Benchmark that represents the minimal additional return required by SURS to pursue Active Management for a given Asset Class. AMPs shall not exceed 2.00%.

**Active Share** means a measure of how the security holdings of a given portfolio differ from the holdings of an index or Benchmark.

**Alternative** means an investment in an Asset Class, other than public Equities, public Fixed Income and Cash.

**Annualized Alpha** means a measure of the relationship between a Fund performance and the performance of a Benchmark and equals the excess return where the Benchmark return is zero.

**Annualized Return** means the return realized over a period of time, expressed as a time-weighted annual percentage.

**Appropriation** means to set aside money for a specific purpose. A company or a government appropriates funds in order to delegate cash for the necessities of its business operations.

**Asset Allocation** means an investment portfolio technique that aims to balance risk and create diversification by dividing assets among major Asset Classes, such as Equities, Fixed Income, Cash and Alternatives.

**Asset Class** means a group of securities that exhibits similar characteristics, behaves similarly in the marketplace and is subject to the same laws and regulations. Major Asset Classes include Equities, Fixed Income, Cash and Alternatives.

**Asset Class Percentage** means, with respect to the Strategic Policy Target, Interim Policy Target or Policy Portfolio, the percentage that a given Asset Class represents of the total.

**Asset/Liability Position** means a measurement, as of a point in time, of the System's ability to meet its future obligations with available assets and future cash inflows.

**Asset/Liability Study** means an analysis of the System's available assets and future cash flow (including Appropriations) and its ability to meet current and future Member benefits and other System obligations.

**Assets Under Management** means the market value of assets that a Manager manages on behalf of investors.

**Assumed Rate of Return** means the Expected Rate of Return adopted by the Board as one of the actuarial assumptions used to determine the System's net pension liability in accordance with GASB Statement No. 67.

**Board** means the SURS Board of Trustees.

**Broker/Dealer** means a firm in the business of buying and selling securities that may act as either an agent or a principal in a transaction.

**Benchmark** means a standard against which the performance of a Manager can be measured and usually consists of a market index or market-segment index representative of a Manager's investment style.

**Beta** means a measure of volatility, or systematic risk, of a security or portfolio in comparison to the market as a whole.

**Calendar Year Returns** means trailing period returns ending on the last day of the calendar year.

**Cash Flow** means the net amount of cash moving into and out of an account or an entity.

**Cash Overlay Manager** means a Manager that is used to minimize an unintended cash position in a portfolio or to transition a portfolio in need of Rebalancing.

**Cash Overlay Services** means various financial techniques such as Futures and Options to achieve a given overlay strategy.

**Chief Investment Officer or CIO** means the executive position responsible for SURS' investment portfolio.

**Closed-end Fund** means an investment company that raises a fixed amount of capital, through an initial public offering, by issuing a fixed number of shares.

**Commingled Fund** means an institutional fund which invests in a portfolio of assets and is funded by pooling the investments of multiple investors.

**Commodity** means a basic good, most often used as an input into the production of other goods or services.

**Consultant** means any General Consultant or Special Consultant retained or employed by the Board to perform some or all of the roles set forth in Section IV.

**Core Fixed Income** means a Sub-Asset Class consisting of Traditional Fixed Income, Core Plus Fixed Income and Unconstrained Fixed Income securities.

**Core Plus Fixed Income** means a Sub-Asset Class consisting of Traditional Fixed Income securities plus other instruments such as high yield, global or emerging market debt and asset-backed securities.

**Core Real Estate** means a Sub-Asset Class consisting of real estate assets that are well located and well leased with strong quality tenants and which provide stable income with low volatility.

**Covariance of Returns** means the measure of the degree to which returns on two risky assets move in tandem, with positive covariance describing two asset returns that move together and negative covariance describing two asset returns that move inversely.

**Custodian** means an organization that meets the requirements set forth in Section IV.

**Defined Benefit Plan** means the SURS' Traditional Benefit Package and the Portable Benefit Package that provide retirement, disability, death and survivor benefits to eligible participants and annuitants.

**Defined Contribution Plan** means the SURS' Self-Managed Plan.

**Derivative** means a security or contract with a price that is dependent upon, or derived from, one or more underlying assets, financial indices, or other standards of measurement.

**Direct Real Estate** means a Sub-Asset Class consisting of both Core Real Estate and Non-core Real Estate.

**Down Capture Ratio** means the percentage of the market's Downside movement 'captured' or achieved by a Fund.

**Emerging Investment Manager** means, as defined by 40 ILCS 5/1-109.1(4), "a qualified investment adviser that manages an investment portfolio of at least $10,000,000 but less than $10,000,000,000 and is a 'minority owned business', 'female owned business' or 'business owned by a person with a disability' as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act."

**Emerging Markets Debt or EMD** means a Sub-Asset Class consisting of Fixed Income securities of emerging market countries.

**Employee** means a person employed for wages or salary, especially at a nonexecutive level.

**Enhanced Review** means, at a semi annual review, a Manager's three (3) year or five (5) year rolling Annualized Alphas (net of fees) are above their respective Benchmarks but below their AMPs.

**Equity** means a stock or other security representing an ownership interest in an entity.

**Excess Return** means the difference between the Rate of Return on a Fund, Asset Class or the Portfolio and the Rate of Return of the applicable Performance Target or Benchmark, as applicable.

**Excess Risk-Adjusted Return** means the difference between the Risk-Adjusted Return on a Fund, Asset Class or the Portfolio and the Rate of Return of the applicable Performance Target.

**Executive Director** means the chief executive officer of SURS.

**Existing Service Provider** means a Service Provider that is currently under contract with SURS to provide a given investment related service.

**Expected Rate of Return** means a probability weighted estimate of a range of future rates of return.

**External Counsel** means a law firm that is engaged by SURS, from time to time, to provide legal services in connection with its investment activities.

**Fixed Income** means, as related to securities, an investment that provides a return in the form of a fixed periodic payment, with the eventual return of principal over time or at maturity.

**Fund** means a securities portfolio, that may take various legal forms and that is designed to meet various investor requirements.

**Fund-of-Funds** means a multi-manager investment, in which a single Manager manages a fund that invests in multiple underlying funds, each managed by s separate Manager.

**Future** means a legal agreement to buy or sell a Commodity or financial instrument at a predetermined price at a specified time in the future.

**General Consultant** means an investment advisor hired by the Board to provide a broad range of investment advice.

**General Counsel** means the chief legal officer of SURS.

**Good Standing** means, at a semi annual review, a Manager's three (3) year and five (5) year rolling Annualized Alpha (net of fees) each exceed their AMPs for such periods. Managers with less than a five (5) year performance history will be considered in Good Standing.

**Hedged Strategies** means the range of Hedge Fund styles included in the Portfolio.

**Hedge Fund** means an Alternative investment designed either to generate above market returns (through Active Management) or more moderate returns (with a reduction in downside risk), while generating low correlation with other Asset Classes.

**Hedge Fund-of Funds** means a Fund-of-Fund structure with Hedge Funds as the underlying funds.

**Illinois Compiled Statutes** means the codified statutes of a general and permanent nature of Illinois. The compilation organizes the general Acts of Illinois into 67 chapters arranged within 9 major topic areas.

**Illinois Pension Code** means a Code that determines how pension funds in Illinois operate. The Pension Code also administers pension funds benefit plans.

**Information Ratio** means a measure of the degree to which a Fund has outperformed its Benchmark to the consistency by which the Fund has outperformed the Benchmark, defined as the Fund's Excess Return (relative to its Benchmark) divided by the Fund's Tracking Error.

**Infrastructure** means the physical structures, networks and other facilities that provided services essential to economic productivity, including transportation, communication, utilities and social assets such as schools, hospitals and public buildings.

**Interim Policy Target** means the intermediate Target Allocation Percentages for each Asset Class, reflecting the necessity of a gradual shift of assets to the Strategic Policy Target, due to practical implementation considerations and Liquidity constraints.

**Investment Committee** means a committee consisting of at least three (3) members of the Board that assists the Board in the development of investment strategies and the review of prospective investments with the goal of supporting the Board in prudent investment and expenditure of System assets.

**Investment Management Agreement** means the legal contract between SURS and a Manager, setting forth the duties and obligations of the parties with respect to the Manager's investment management engagement.

**Investment Manager Termination Guidelines** means those guidelines set forth in Section IX.

**Investment Risk Management Policy** means the policy set forth in Section VI.

**Liquidity** means the degree to which an asset or security can be quickly bought or sold in the market for cash, without affecting the asset's or security's price.

**Liquidity Premium** means a premium demanded by investors to invest in a security that is considered to be illiquid and not easily converted to cash without a loss in value.

**Long Only** means an investment style where assets represent only Long Positions.

**Long Position** means a holding of assets, whereby the value of such position will rise if the price of the security increases.

**Long/Short** means an investment style that allows for both Long Positions and Short Positions, where the value of 'short positions' rise when the price of the security falls.

**Marketable Securities** means securities that may be bought or sold, typically on a public exchange, and quickly converted to cash.

**Manager** means an external investment manager that manages a given portfolio of securities on behalf of SURS under an Investment Management Agreement and pursuant to Manager Guidelines.

**Manager Diversity Program or MDP** means a program to support Emerging Investment Managers in their early stages of development.

**Manager Evaluation Report** means a report documenting the annual evaluation of a Manager by the Consultant and Staff, including recommended action to the Board.

**Manager Guidelines** means a set of investment guidelines that governs a Manager's investment activities.

**Manager Termination Guidelines** means the set of guidelines set forth in Section IX of this Policy.

**Member** means an individual that is eligible under the Defined Benefit Plan to receive retirement, disability, death, or refund benefits as authorized under the Illinois Compiled Statutes.

**MFDB** means a minority-owned business, a female-owned business or a business owned by a person with a disability as those terms are defined in the Business Enterprise for Minorities, Females and Persons with Disabilities Act.

**MFDB Manager Utilization Goals** means those goals, as revised from time-to-time, set forth in Appendix 8.

**Minority-owned Broker/Dealer** means, in accordance with 40 ILCS 5/1-109.1, a qualified broker-dealer who meets the definition of 'minority owned business', 'female owned business', or 'business owned by a person with a disability', as those terms are defined in the Business Enterprise for Minorities Females, and Persons with Disabilities Act."

**Non-Core Real Estate** means a Sub-Asset Class consisting of real estate assets in need of re-tenanting, redevelopment or renovation, or is otherwise in some form of distress.

**Open-end Fund** means a Fund that does not have any restrictions on the amount of shares it can issue and that can issue and redeem shares at any time.

**Opportunity Fund** means an Asset Class consisting of investments that are opportunistic in nature and may or may not transition into a more permanent Asset Class.

**Option** means a contract between a buyer and a seller that gives the buyer the right, but not the obligation, to buy or sell a particular asset at a later date and at an agreed upon price.

**Passive Management** means a management style that attempts to replicate a market index or Benchmark.

**Performance Evaluation** means a measurement of a Manager, Asset Class or the total Portfolio versus various standards of performance.

**Performance Statistics** means analytical tools such as the Sharpe Ratio, Information Ratio, Annualized Alpha, Treynor Ratio, Sortino Ratio, Up Market Capture and Down Market Capture.

**Performance Target** means, for (i) an Active Manager, the applicable Benchmark for such Manager's given Asset Class or style, plus the Active Manager Premium, as set forth in Appendix 5; (ii) for a Passive Manager, the applicable Benchmark for such Manager's given Asset Class; (iii) for an Asset Class, such Asset Class' applicable Benchmark and (iv) for the Portfolio, the blended Benchmarks of the Policy Portfolio.

**Portfolio** means the investment portfolio of the Defined Benefit Plan.

**Portable Benefit Package** means one of two packages offered under SURS' Defined Benefit Plan that offers a more generous separation refund in exchange for a reduction in retirement and death benefits.

**Potential Consultant** means a Consultant that is being considered for selection by SURS.

**Potential Custodian** means a Custodian that is being considered for selection by SURS.

**Potential Manager** means a Manager that is being considered for selection by SURS.

**Potential Vendor** means a Vendor that has been previously vetted and/or approved.

**Potential Service Provider** means a Service Provider that is being considered for selection by SURS.

**Policy** means this Policy, as amended from time to time.

**Policy Portfolio** means a portfolio comprised of Asset Class benchmarks, reflecting a passive implementation of SURS Strategic Policy Target, as amended form time to time.

**Private Equity** means equity investments in private companies, either directly or through buyouts of public companies that result in a delisting of public Equity.

**Qualified Fund-of-Fund Management Services** means, per 40 ILCS 5/113.15, either (i) the services of an investment adviser acting in its capacity as an investment manager of a Fund-of-Funds or (ii) an investment adviser acting in its capacity as an investment manager of a separate account that is invested on a side-by-side basis in a substantially identical manner to a Fund-of-Funds, in each case pursuant to qualified written agreements.

**Quarterly Investment Update** means a quarterly report generated by Staff and distributed to Members that summarizes investment results for the System.

**Quarterly Reporting Period** means a three-month period on a financial calendar that acts as a basis for the reporting of investment performance, earnings, the paying of dividends, etc.

**Quiet Period** means a period of time during which a search for a Potential Consultant, Custodian, Manager or Vendor is underway and during which a set of guidelines governs any communication by the Board, Consultant or Staff with such parties.

**Rate of Return** means is a profit on an investment over a period of time, expressed as a proportion of the original investment.

**Real Assets** is an asset class consisting of equity or debt investments in land, buildings, infrastructure, and natural resources..

**Reassessment** means, at a semi annual review, A Manager's (i) three (3) year and five (5) year rolling Annualized Alphas (net of fees) are below their respective Benchmarks for the preceding two consecutive quarters, and (ii) three (3) year and five (5) year Information Ratios are negative for the preceding two consecutive quarters; or other performance metrics reflect a significant negative trend.

**Rebalancing** means the process of adjusting Asset Class Percentages to bring them back into alignment with Target Allocation Percentages.

**Rebalancing Manager** means a Manager that is used to facilitate a Rebalancing of the Portfolio.

**Request For Proposal or RFP** means a formal solicitation for a service or Service Provider, made through a competitive bidding process.

**Risk-Adjusted Return** means the Annualized Alpha for a Fund or Asset Class.

**Risk Statistics** means analytical tools such as Standard Deviation, Tracking Error, Beta, R-Squared and Active Share.

**R-Squared** means the percentage of a Fund's movements that can be explained by movement of the Benchmark.

**Securities Lending** means the temporary loan of a security from an institutional investor's portfolio to a broker/dealer or dealer bank to support that firm's trading activities. These trading activities include short selling, selling on margin or the satisfaction of some other type of transaction. Loaned securities are generally collateralized, reducing the lender's credit exposure to the borrower. Except for the right to vote proxies, the lender retains entitlement to all the benefits of owning the original securities, including the receipt of dividends and interest.

**Separate Account** means a privately managed investment account that is designed and managed specifically for an investor.

**Service Provider** means any Consultant, Manager, Custodian or Vendor.

**Sharpe Ratio** means a measure of a Fund's return or an Asset Class' return (Fund or Asset Class Rate of Return less the return of the risk-free rate) relative to its risk (Standard Deviation of the Fund or Asset Class).

**Short Position** means a sale of a borrowed security, whereby the value of such position will rise if the price of the security falls.

**Special Consultant** means an investment advisor hired by the Board to provide a limited range of services.

**Sortino Ratio** means a measure of a Fund's return or Asset Class' return (Fund or Asset Class Rate of Return less the return of the risk-free rate) relative to its downside risk (downside deviation of Fund or Asset Class).

**Staff** means the SURS investment staff.

**Standard Deviation** means a measure of the dispersion of a set of data from its mean, calculated as the square root of variance.

**State Universities Retirement System of Illinois or SURS or System** means the pension fund established for the benefit of the staff members and employees of the Illinois state universities, community colleges and certain other state educational and scientific agencies, and the survivors, dependents, and other beneficiaries of those employees.

**Strategic Plan** means SURS' process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy

**Strategic Objectives** mean the objectives listed in Section II, as amended from time to time.

**Strategic Policy Target** means the total of all approved Target Allocation Percentages.

**Sub-Asset Class** means a subset of an Asset Class that shares common characteristics with both the Asset Class and such subset.

**Swap** means a Derivative contract through which two parties exchange financial obligations.

**Target Allocation Percentage** means the target percentage of each major Asset Class in the Strategic Policy Target.

**Termination** means the cancellation of a contract and related obligations.

**Tracking Error** means, with respect to a security investment, the Standard Deviation of the Excess Return.

**Trade Order Entry System** means a web-based program provided by the System's custodian, Northern Trust, to transfer cash from SURS to an external manager.

**Traditional Benefit Package** means one of two packages offered under SURS' Defined Benefit Plan that offers lifetime retirement benefits, but a limited separation refund.

**Traditional Fixed Income** means a Sub-Asset Class consisting generally of investment-grade, Fixed Income securities.

**Trailing Period** means the prior period (months, quarters, years) ending on the date being used for a given analysis.

**Transition Manager** means a Manager that helps transition a portfolio of securities necessitated by the change in a Manager's funding mandate, a Manager's termination or changes in Asset Allocation.

**Treasury Inflation Protected Securities or TIPS** means a Treasury security that is indexed to inflation.

**Treynor Ratio** means a measure of a Fund's return or an Asset Class' return (Fund or Asset Class Rate of Return less the return of the risk-free rate) relative to its risk (Beta of the Fund or Asset Class).

**Up Capture Ratio** means the percentage of the market's upside movement 'captured' or achieved by a Fund.

**Unconstrained Fixed Income** means a Sub-Asset Class consisting of Fixed Income securities that would tend to vary from those typically found in Core Fixed Income or Core Plus Fixed Income.

**Utilization Goals** means the percentage of the total Portfolio or volume of business activity that is to be represented by a specific subset of the Portfolio.

**Variance** means a measurement of the spread of a set of numbers from the mean of the data set.

**Vendor** means a supplier of goods or services.

**Volatility of Return** means a statistical measure of dispersion of returns for a given security, Asset Class or portfolio.

**Weighted Expected Rate of Return** means a probability weighted estimate of a range of future rates of return for a portfolio, with the estimate weighted by the component investments or Asset Classes of the portfolio.

# Appendix 1

## System Assumed Rates of Return

| ***Year Ending*** | ***Assumed Rate of Return*** |
|---|---|
| | |
| 8-31-02 | 8.50% |
| 8-31-03 | 8.50% |
| 8-31-04 | 8.50% |
| 6-30-05 | 8.50% |
| 6-30-06 | 8.50% |
| 6-30-07 | 8.50% |
| 6-30-08 | 8.50% |
| 6-30-09 | 8.50% |
| 6-30-10 | 7.75% |
| 6-30-11 | 7.75% |
| 6-30-12 | 7.75% |
| 6-30-13 | 7.75% |
| 6-30-14 | 7.25% |
| 6-30-15 | 7.25% |
| 6-30-16 | 7.25% |
| 6-30-17 | 7.25% |
| 6-30-18 | 6.75% |

# Appendix 2

## Formal Board Review

| ***Formal Review Agenda Item*** | ***Formal Review Schedule*** |
|---|---|
| Total Fund Performance | At least quarterly |
| Asset Allocation | At least annually |
| Investment Policy | At least annually |
| Manager Performance Evaluation | At least annually |

# Appendix 3

## Managers' Roles and Responsibilities

1. Selection, purchase and sale of specific securities or investments, within the parameters specified by Staff and Consultants and in adherence to this Policy;
2. Construction and management of investment portfolios that are consistent with their specific Manager Guidelines;
3. Providing performance reporting to the Staff at intervals specified by Staff and sufficient to meet the requirements set forth in Section X;
4. On an annual basis, providing Staff with proof of insurance coverage in an amount and type specified in their Investment Management Agreement;
5. On an annual basis, certifying in writing to Staff that they remain a fiduciary to the System and that they have been in compliance with the Manager Guidelines during the past year;
6. Utilizing investment strategies designed to ensure that all securities transactions are executed in such a manner that the total explicit and implicit costs and total proceeds in every transaction are the most favorable under the circumstances;
7. Complying with all applicable laws and regulations, including those of the State of Illinois and the United States of America including, without limitation, the provisions of Rule 206(4)5 under the Investment Advisers Act of 1940, as amended.

# Appendix 4

## Asset Allocation Policy Mix

| | Strategic Policy Target 4/1/2019-10/1/2019 | |
|---|---|---|
| *Public Equity* | *54%* | |
| US Equity | | 23% |
| Non-US Equity | | 19% |
| Global Equity | | 8% |
| REITs | | 4% |
| *Total Alternatives* | *20%* | |
| Real Assets** | | 5% |
| Options Strategies | | 4% |
| Hedged Strategies | | 1% |
| Commodities | | 2% |
| Private Equity | | 6% |
| Non-Core Real Assets** | | 2% |
| *Fixed Income* | *26%* | |
| TIPS | | 4% |
| Emerging Market Debt | | 3% |
| Fixed Income | | 19% |
| **<u>CRO</u>** | **0%** | |
| *Opportunity Fund* | *0%* | |
| **Total** | **100%** | |

| | Long-Term Strategic Policy Target | |
|---|---|---|
| **<u>Broad Growth</u>** | **66%** | |
| *<u>Traditional Growth</u>* | *25%* | |
| US Equity | | |
| Non-US Equity | | |
| Global Equity | | |
| *<u>Stabilized Growth</u>* | *26%* | |
| Real Assets** | | 6% |
| Options Strategies | | 6% |
| <u>Credit***</u> | | 14% |
| *<u>Non-Traditional Growth</u>* | *15%* | |
| Private Equity | | 11% |
| Non-Core Real Assets | | 4% |
| **<u>Inflation Sensitive</u>** | **6%** | |
| TIPS | | |
| Commodities | | |
| **<u>Principal Protection</u>** | **8%** | |
| **<u>CRO</u>** | **20%** | |
| *Opportunity Fund* | *0%* | |
| **Total** | **100%** | |

**Includes Real Assets and Infrastructure investments.

***Credit will inlude EMD, HY, Loans, Invest. Grade, and other income-driven strategies.

1. No Open-end Fund may represent more than 30% of Core Real Estate portfolio.
2. No Non-Core Real Estate Fund may represent more than 10% of the Non-Core Fund commitments.
3. No single manager may represent more than 40% of the combined Real Asset and Non-Core Real Asset target allocation
4. Allocation to the Opportunity Fund class may not exceed 5%.

**<u>Bold</u>** are approved major strategic classes.

<u>Underlined</u> and *<u>underlined italics</u>* are approved sub-asset classes.

*Italics* are legacy major asset classes.

## Appendix 5

### Benchmarks and Active Manager Performance Targets

As of 3-31-19

| ***ASSET CLASS POLICY MIX*** | ***BENCHMARK*** | ***PERFORMANCE TARGET*** |
|---|---|---|
| ***Total Broad Growth Aggregate*** | Blend of Blends | |
| ***Traditional Growth*** | Blend | |
| *U.S. Equity* | Dow Jones U. S. Total Stock Market Index | |
| *Large Cap* | | BM+0.50% |
| *Large Cap Structured Active* | | BM+0.75% |
| *Mid Cap (Core, Growth, Value)* | | BM+1.0% |
| *Small Cap (Core, Growth, Value)* | | BM+2.0% |
| *Non-U.S. Equity* | MSCI ACW Ex-US | |
| *Large Cap Non-US Developed* | MSCI EAFE | BM+2.0% |
| *All Cap Non-US Equity* | MSCI ACW Ex-US | BM+2.0% |
| *Structured Active Non-US Equity* | MSCI ACW Ex-US | BM+1.50% |
| *Emerging Markets* | MSCI Emerging Markets Index | BM+2.0% |
| *Global Equity* | MSCI All Country World | BM+2.0% |
| *REITS* | FTSE EPRA/NAREIT Developed Index | BM+1.0% |
| | | |
| ***Stabilized Growth*** | Blend | |
| *Hedged Strategies* | LIBOR<br>Secondary Benchmark may include HFRI Fund of Funds Composite Index | BM+5.0% |
| *Options Strategies* | Blend of two benchmarks:<br>Bench 1: [25% CBOE S&P 500 PutWrite / 25% CBOE S%P 500 BuyWrite / 25% MSCI ACWI ex US ND / 25% 3-month T-bill]<br>Bench 2: [CBOE S&P 500 PutWrite] | BM% |
| ***Total Credit*** | 25%IG+30%HY+30%EMD+15%BL Blend | BM + 0.50% |
| *Investment Grade* | BB Global Agg Credit Index | BM + 0.50% |
| *High Yield* | BB Global High Yield | BM + 0.50% |
| *Emerging Market Debt (EMD)* | 50 % JPM Gov. Bond Index - EM Global Div. + 25% JPM EM Bond Index - Global Diversified + 25% JPM Corp. EM Bond Index - Broad | BM + 0.50% |
| *Bank Loans* | S&P LSTV Global Leveraged Loan | BM + 0.50% |
| *Real Assets* | Blend | |
| *Core Real Estate* | NFI-ODCE Value Weight Net | BM% |
| *Infrastructure* | Weighted Average of the Underlying Investment Benchmarks | BM% |

| | | |
|---|---|---|
| ***Non-Traditonal Growth*** | Blend | |
| *Private Equity* | Dow Jones U.S. Total Stock Market Index<br>Secondary Benchmarks may include: peer group comparison, return multiple or public market equivalent comparisons. | BM+3.0% |
| *Non-core Real Assets* | NFI-ODCE Value Weight Net | BM+1.5% |
| | | |
| ***Principal Protection*** | Bloomberg Barclays Intermediate Agg. Ex Credit | BM% |
| | | |
| ***Total Inflation Sensitive*** | Blend | |
| *TIPS* | Barclays Capital U.S. TIPS Index | BM+0.30% |
| *Commodities* | Bloomberg Commodity Index | BM+1.0% |
| | | |
| ***Total Crisis Risk Offset*** | 35%LD+40%STF+25%ARP Blend | BM |
| *Long Duration* | BB Long Government Index | BM |
| *Systematic Trend Following* | CS Managed Futures (15%Vol) | BM |
| *Alternative Risk Premia* | 90 Day Treasury Bills + 2.0% | BM |
| | | |
| ***Grand Total*** | Policy Portfolio | |

## Appendix 6

| *Asset Class* | *Goal for Minorities* | *Goal for Females* | *Goal for Persons with a Disability* | *Overall Active Goal* |
|---|---|---|---|---|
| **Equities** | **20%** | **10%** | **0-2%** | **30%** |
| **Fixed Income (includesTIPS)*** | **12%** | **8%** | **0-1%** | **20%** |
| **Alternative Investments** | **0-20% of new allocations** | **0-20% of new allocations** | **0-20% of new allocations** | **20% of new allocations** |
| | | | | |
| **Total Fund** | **16%** | **8%** | **1%** | **25%** |

***Includes allocations to Principal Protection, Credit, Tips, and Long Duration**

### SURS Utilization Goals for Active Emerging Investment Managers

### Aspirational Goals per 40 ILCS 5/1-109.1

| *Group* | *Goal* |
|---|---|
| **Emerging Investment Managers** | **Not less than 20% of Assets Under Management** |
| **MFDB Managers** | **Not less than 20% of Managers** |

# Appendix 7

## System Utilization Goals for Minority-owned Broker/Dealers

| ***Asset Class*** | ***Goal*** |
|---|---|
| U.S. Equity | 30.0% |
| Non-U.S. Equity | 15.0% |
| Fixed Income | 20.0% |

# Appendix 8

## Manager(1) Utilization Goals for Minority-owned Broker/Dealers

| ASSET CLASS | MINIMUM EXPECTATION | ELIGIBLE TRADE VOLUME | ELIGIBLE COMMISSIONS |
|---|---|---|---|
| **Equity:** | | | |
| Active U.S. Equity | 30.0% | | X (1)(2) |
| Passive U.S. Equity | 35.0% | | X (1)(2) |
| Structured Active U.S. Equity | 20.0% | | X (1)(2) |
| Non-U.S. Equity | 15.0% | | X (1)(2)(3) |
| Global Equity | 20.0% | | X (1)(2)(3) |
| REITS | 15.0% | | X (1)(2)(3) |
| **Fixed Income*:** | | | |
| (including TIPS) | 20.0% | X (1)(2)(3) | |

***Includes allocations to Principal Protection, Credit, Tips, and Long Duration**

‘(1) Separate account managers.
‘(2) Exception for electronic trading.
‘(3) Exception for emerging markets, as defined by Morgan Stanley Capital International.