

School Employees  
Retirement System  
of Ohio

**Statement of  
Investment Policy**

Adopted: October 20, 2005

**SERS**

# STATEMENT OF INVESTMENT POLICY

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# STATEMENT OF INVESTMENT POLICY

## **Purpose**

The purpose of this Statement of Investment Policy (Statement) is to define the Retirement Board's investment philosophy and objectives for the School Employees Retirement System (SERS). This Statement sets forth policies and describes the organization and division of responsibilities to prudently implement the Board's philosophy and objectives in accordance with Chapter 3309 of the Ohio Revised Code. It also establishes the framework and specific objectives to monitor investment performance and proxy voting, and to promote effective communication between the Board, the Investment Staff, and Investment Managers.

The contents of this Statement are subject to change at any time by the Board. The Statement will be reviewed and revised periodically to assure that it continues to reflect the philosophies, expectations and objectives of the Board.

## **Background**

SERS was established to provide retirement and disability benefits for all non-certificate holding persons employed by Ohio's school districts. This purpose is funded by the member and employer contributions and returns realized from investment of those contributions.

A nine-member board governs the system with responsibility for the investment function as set forth in the Ohio Revised Code. In addition to the investment function, the Ohio Revised Code also sets forth the fiduciary responsibility of the Board and of other fiduciaries in discharging their duties with respect to the fund. This Statement incorporates and is subject to all restrictions, guidelines and obligations set forth by the Ohio Revised Code.

The System invests over the long term. SERS' time horizon is assumed to be 30 years.

## **I. Investment Objective, Risk Management and Implementation Approach**

### **A. Investment Objective**

The Board realizes that its primary objective is to assure that SERS meets its responsibilities first to provide statutorily mandated retirement benefits and then to provide other permissive benefits as authorized by the Board. In defining investment objectives the Board seeks to enhance the investment returns of the fund in order to permit higher benefits while minimizing the costs to administer the fund and manage the investments. Thus, the fund should earn over the long-term a total fund return that equals or exceeds the actuarial discount rate approved by the Board when setting SERS' funding policy. The Board believes the investment policies

summarized in this Statement will achieve this objective at an acceptable level of risk. The Board evaluates risk in terms of the probability of not earning the actuarial discount rate over a 30-year time horizon.

## **B. Risk Management**

The Board believes that over the long-term there is a positive correlation between the level of investment risk taken and rates of investment return realized. The Board further believes that the assumption of a moderate level of risk associated with investments is reasonable and justified in order to enhance potential long-term investment results. The Board shall always act to assure that the level of investment risk in the portfolio shall be prudent and shall not jeopardize the primary objective to first provide statutorily mandated retirement benefits and then to provide other permissive benefits as authorized by the Board.

Diversification by asset class, by investment approach and by individual investments within each asset class will be employed to reduce overall portfolio risk and volatility.

## **C. Implementation Approach**

In order to monitor and control the activities within the investment function, the Board has reserved certain responsibilities for itself. It has also delegated certain responsibilities to the Executive Director, to the Investment Staff, to Investment Managers, to consultants or other entities providing investment services to SERS. These responsibilities are described in this Statement.

In fulfilling its fiduciary duties, the Board utilizes a competent and qualified Investment Staff. Investment Staff is assigned, among other duties, oversight of professional external Investment Managers. The Board authorizes the Investment Staff to direct funds in accordance with this Statement. Investment Managers are selected for their expertise to manage certain portions of SERS' portfolio.

The Board requires regular reporting on the fund's investments in order to assure proper compliance with the Board's policies.

## **II. Investment Organization and Responsibilities**

### **A. Responsibilities of the Board**

The Board recognizes its responsibility to ensure that the assets of SERS are managed effectively and prudently, in full compliance with all applicable laws and Board policies, guidelines and objectives; and for the exclusive benefit of participants and beneficiaries. The Board believes it can best manage those responsibilities by delegating certain specific duties to others, as described below. In addition, the Board may designate certain Board members to act as a Subcommittee from time to time, and may delegate certain decision-making or fact-finding responsibilities to that subcommittee.

Specific responsibilities of the Retirement Board or its Subcommittee are as follows:

1. Establish controls and systems to ensure that fiduciaries comply with all applicable laws.
2. Establish asset allocations, investment policies, guidelines and objectives for the assets of SERS and communicate them to the Investment Staff and Investment Managers.
3. Appoint and discharge those with responsibility for managing SERS' assets, including Investment Managers, Investment Consultants, Executive Director and any others involved.
4. Approve the list of qualified Investment Managers who shall be known as Approved Investment Managers.
5. Monitor and review the investment performance of SERS to determine achievement of objectives and compliance with this Statement and applicable laws.
6. Establish a proxy policy; and review proxy governance issues with Investment Staff at least annually.
7. Request, receive and review reports from the Investment Staff, Investment Consultant or when applicable from other investment entities.
8. Review and approve the Annual Investment Plan including the policy with the goal to increase utilization of Ohio-qualified investment managers and agents. In addition the Board must approve any intra-year changes to the Annual Investment Plan.

#### **B. Responsibilities of the Staff**

The Staff shall administer the assets of SERS in accordance with all: applicable federal and state law and regulations, including but not limited to, applicable ethics requirements; the policies, guidelines and objectives adopted by the Board; and applicable professional codes and/or regulations.

The Executive Director has the following responsibilities:

1. Ensure necessary reports on SERS' investment results are presented on a timely basis as required under this Statement, or as requested by the Board.
2. Retain any consultants or advisors deemed necessary or desirable for assistance in the investment of SERS' assets, and for meeting the Executive Director or Investment Staff's responsibilities. These consultants would be in addition to any consultants hired by the Board.
3. Recommend the appointment or discharge of Investment Managers.
4. Oversee the investment function.

The Director of Investments has the following responsibilities:

1. Prepare and recommend an Annual Investment Plan for the investment of SERS' assets with recognition of the target asset mix ratios and the permissible ranges for asset allocation established by the Board.
2. Implement the Annual Investment Plan, exercising the judgments allowed by the Board as to the asset allocation ranges for that year.
3. Report to the Board any intra-year changes in the Annual Investment Plan; in the asset allocation among managers; or proposed changes in the policy, guidelines or objectives which the Investment Staff deems desirable or which are recommended by an Investment Manager, Consultants or other entities providing investment services to SERS.
4. Research new investment strategies and recommend strategies with appropriate risk and return characteristics to the Executive Director and the Board.
5. Inform Investment Managers, Consultants or other entities providing investment services to SERS the requirements of applicable law and the policies, guidelines and objectives adopted by the Board including the proxy policy; and monitor their compliance.
6. Approve the Investment Staff's recommendation to increase or decrease the amount of assets managed by individual Investment Managers.
7. Recommend the appointment or discharge of Investment Managers to the Executive Director and the Board.
8. Supervise the Investment Staff.
9. Monitor and evaluate the effectiveness of securities transactions executed on behalf of the Board and report annually to the Board the performance of agents that execute securities transactions on behalf of the Board.

The Investment Staff has the following responsibilities:

1. Promptly vote or instruct SERS' Approved Investment Managers to vote all proxies and related actions in a manner consistent with this Statement; and maintain detailed records of all proxy voting and related actions for the Director of Investments.
2. Report, at least quarterly, the status of the portfolio and its performance for various time periods to the Director of Investments.
3. Consult with Approved Investment Managers periodically to discuss account progress and other material information.
4. Evaluate each Approved Investment Manager's ability to continue managing assets for SERS.

5. Recommend to the Director of Investments that assets be added to or withdrawn from existing Investment Managers.
6. Recommend the appointment or discharge of Investment Managers to the Director of Investments.
7. Invest assets in the short-term portfolio as authorized by the Board.
8. Research new investment strategies and recommend strategies with appropriate risk and return characteristics to the Director of Investments.
9. Prepare an annual report for the Director of Investments on the performance of agents that execute securities transactions on behalf of the Board.

### **C. Responsibilities of the Approved Investment Managers**

Each Approved Investment Manager and any Investment Staff member internally managing assets, is responsible for the specified investment management accountability unit which it manages.

Each Approved Investment Manager and internal Staff member shall:

1. Manage the assets and the allocation of those assets within its control in compliance with all: applicable federal and state law and regulations including but not limited to, applicable ethics requirements; the policies, guidelines and objectives adopted by the Board; all contractual obligations; and applicable professional codes and/or regulations.
2. Inform the Executive Director, Director of Investments and Investment Staff of any substantial changes in investment strategy; portfolio structure; value of assets; and of any organizational changes, including that of ownership, affiliation, organizational structure, financial condition, or changes in professional personnel staffing in the investment management organization.
3. Prepare reports for the Director of Investments and Investment Staff on a semi-annual basis, prior to any scheduled meetings, or as may be requested.
4. Recommend to the Director of Investments any changes in policy, guidelines or objectives which the Investment Manager believes to be desirable.
5. Select such agents for the execution of transactions, at such prices, and at such commission rates as in the good faith judgment of the Investment Manager will be in the best interest of the System's assets, taking into consideration in the selection of such agents not only the available prices and rates of brokerage commissions, but also other relevant factors to the transaction.

## **D. Responsibilities of the Investment Consultant to the Board**

The Investment Consultant shall:

1. Provide independent and unbiased research, information and advice to the Board and SERS Staff.
2. Assist in the development and amendment of this Statement.
3. Assist in the development of strategic asset allocation targets.
4. Assist in the development of performance measurement standards.
5. Monitor and evaluate Investment Manager performance on an ongoing basis.
6. Collaborate with Investment Staff in the due diligence of potential new Investment Managers and existing Investment Managers, as requested.
7. Assist in the development of criteria and procedures to be utilized for the selection of Investment Managers.
8. Provide research, information and advice on investment topics and strategies considered relevant by the Investment Consultant, or when requested by Investment Staff.
9. Provide any other advice or services that the Board, Executive Director or Director of Investments determines from time to time are necessary, useful or appropriate to fulfill the objectives of this Statement.
10. Provide services in accordance with all applicable federal and state law and regulations including, but not limited to, applicable ethics requirements; and with all applicable professional codes and/or regulations.

## **III. Investment Guidelines**

The following non-inclusive methods provide implementation guidelines for the Investment Staff. The Board may periodically approve other guidelines for Staff.

### **A. Asset Allocation Guidelines**

It is the Board's responsibility to determine the allocation of assets among distinct capital markets. The procedure for determining the allocation will consider the relevant characteristics of the liabilities and potential assets of SERS. Typically the Board will conduct an asset and liability study every three to five years unless substantial changes occur which require that a new study be done sooner.

The liability considerations shall include, but not be limited to, current and expected future values of the benefits, contributions and total assets. These factors are important for identifying the investment horizon of SERS and its cash flow requirements.



Based on an asset and liability study conducted by SERS' Investment Consultant which analyzed the expected returns of various asset classes, projected liabilities of SERS and the risks associated with various asset mix strategies, the Board has established the following asset allocation for SERS:

<u>Asset Class</u>	<u>Target</u>	<u>Range</u>
<u>Equity Securities</u>		
U.S. Equities	46%	41% - 51%
Non-U.S. Equities	16%	11% - 21%
Private Equity	3%	1% - 5%
Total Equities	65%	62% - 68% *
<u>Fixed Income Securities</u>		
Domestic Fixed Income	23%	20% - 26%
Real Estate	10%	5% - 15%
Cash Equivalents	2%	0% - 3%
Total	100%	

\* Lower end of range can be 1% lower until private equity reaches target.

## **B. Derivatives Guidelines**

A derivative is an instrument that derives its value from an underlying asset or security. Examples are futures contracts, forward contracts, and options. SERS uses derivative instruments for the purpose of meeting the Fund's investment objectives.

Derivatives are used for the following purposes:

- Rebalancing
- Managing portfolio characteristics within an asset class
- Hedging currency exposure
- Managing other risk exposure not covered above

Use of derivatives for speculative purposes is prohibited.

Derivative positions established by Investment Staff will be reported at each Board meeting.

The Board permits the use of derivatives such as futures, options, forwards, swaps and similar securities for use by Investment Staff and SERS' Investment Managers as long as the securities are not used for speculative purposes.

### **C. Rebalancing Guidelines**

Asset allocation represents a long term strategy and is one of the most important investment decisions made by the Board. It is the responsibility of the Investment Staff to ensure that this major decision is efficiently and consistently implemented. Over time, market events will cause the actual allocation to vary from the target allocation. Rebalancing is the action of bringing the actual allocation back toward the target allocation and within its permissible range.

The Asset Allocation Guidelines provide permissible ranges for each asset class. When the actual allocation falls outside these ranges, Investment Staff will take actions to bring the actual allocations toward the target allocation. Investment Staff may take actions to bring the actual allocations toward the target allocation prior to the actual allocation falling outside their ranges. Cost and timeliness are two of the factors that may be considered in implementing a rebalancing program. On a temporary basis, up to three months, derivative instruments may be used as a low-cost and efficient method for rebalancing.

### **D. Currency Hedging Guidelines**

Currency hedging is utilized in the Non-US equity portfolio to reduce the affect of foreign currency valuation changes versus the US dollar on the investment returns of the Non-US portfolio.

Currency hedging can be utilized either through passive management, active management or a combination of both.

### **E. Transition Management Guidelines**

A Transition Manager may be used to facilitate the movement of assets or cash among managers. A Transition Manager has expertise in moving a large amount or number of assets quickly with the least amount of cost and market impact.

Transition Managers may be used when cash is being added to or withdrawn from an existing Investment Manager. The Transition Manager may also be used when an Investment Manager is first hired or when they are dismissed. Investment Staff will determine when it is appropriate to retain a Transition Manager.

The Board's current Investment Consultant cannot be used as a Transition Manager unless specifically approved by the Board.

## **F. Proxy Voting Guidelines**

The Board believes that proxy voting rights have economic value and it is a fiduciary responsibility to assure that the voting of common stock proxies are in the best interest of the members and retirees. Annually the Board shall approve the “Proxy Policy Guidelines and Procedures.” Investment Staff, Investment Managers, and third-party proxy voting agents will use the “Proxy Policy Guidelines and Procedures” as a guide in voting proxies.

Common stock proxies may be executed by SERS’ Proxy Review Committee, third party proxy voting agents, or Investment Managers. The Director of Investments will inform the Board of significant proxy issues as they arise. Staff reviews proxy voting annually with the Board.

## **G. Securities Lending Guidelines**

Lending securities to qualified borrowers enables SERS to realize incremental income on assets currently in the portfolio. This represents an opportunity to increase the return on the fund with very little additional risk. The Board has authorized Staff to hire one or more security lending agents as necessary to lend SERS’ assets.

## **H. Passive Management Guidelines**

To minimize costs and risk, the Board has approved the use of certain levels of passive management for portions of the U.S. and Non-U.S. equity portfolios. Passive management employs the use of low cost index funds to match the characteristics and performance of an asset class or subclass. Multiple passively managed funds may be used to maintain the diversification and characteristics desired in SERS’ portfolio.

Enhanced index funds are a low cost, low risk strategy that can add some extra return over the benchmark. Enhanced index products can be used as a passive management strategy if approved by the Board.

## **I. Approved Investment Manager Guidelines**

The Board approves Investment Managers to which assets may be assigned by the Investment Staff, but any Investment Manager with a similar style approved by the Board as a backup manager can be selected by the Investment Staff to manage assets for SERS.

Each Investment Manager will be required by contract to adhere to specific investment guidelines as well as all applicable laws. Investment guidelines will be identified in detail in each executed Investment Management Agreement.

It is a goal of the Board to increase the utilization of Ohio-qualified Investment Managers when an Ohio-qualified Investment Manager offers quality, services and safety comparable to other Investment Managers available to the Board, and the use of such Investment Manager is consistent with the Board’s fiduciary duties. A list of Ohio-qualified Investment Managers will be maintained by requesting information from

Investment Managers doing business or seeking to do business with SERS. Notices of searches for Investment Managers, including search criteria, will be posted on SERS' website.

#### **J. Approved Agents Guidelines**

Agents, or broker/dealers who may provide execution of securities transactions for SERS will be evaluated on the basis of financial soundness, underwriting capabilities, research services, execution costs, and any other capabilities necessary in the execution of such transactions.

For those accounts of SERS' assets which are managed externally, Investment Managers may use such agents as they select for execution of such transactions, at such prices, and at such commission rates as in the good faith judgment of the Investment Manager will be in the best interest of SERS' assets, taking into consideration in the selection of such agents not only the available prices and rates of brokerage commissions, but also other relevant factors to the transaction.

It is a goal of the Retirement Board to increase its utilization of Ohio-qualified agents for the execution of domestic equity and domestic fixed income trades when an Ohio-qualified agent offers quality, services, and safety comparable to other agents available to the Retirement Board or its Investment Managers, and the use of such agent is consistent with the Retirement Board's fiduciary duties. A list of Ohio-qualified agents will be maintained by requesting information from agents doing business or seeking to do business with SERS.

#### **K. Security Litigation Guidelines**

As a large institutional holder of equity ownership in public companies, SERS may be deemed to be a member of a class of shareholders involved in litigation against companies, their directors, and officers. Such litigation against a company typically arises from alleged violations of federal and state securities laws relating to disclosure obligations or breaches of fiduciary or other duties. SERS follows an established litigation process to determine the course of action that best represents the interests of SERS' participants and beneficiaries.

### **IV. Performance Monitoring and Control**

Investment Staff monitors performance data provided by SERS' Finance Department on a monthly basis.

#### **A. Performance Measurement Standard**

Performance evaluation for the portfolio shall be the total return, on an accrual accounting basis, including realized and unrealized capital gains and losses, and income. Valuations are to be made at least on a quarterly basis and period returns are to be geometrically linked. Cash and cash

equivalents shall be included in the portfolio's return. Performance shall be calculated on a gross-of-fee basis. The Board may also review performance on a net-of-fee basis.

**B. Performance Benchmark for the Total Fund**

The investment objective of the total fund, as stated in Section I.A. above, is to “earn over the long term (30 years) a total fund return that equals or exceeds the actuarial discount rate”. Performance of the total fund relative to benchmarks will be examined more frequently, on a one quarter, one year, three year and five year basis, with emphasis on the three and five year periods.

The performance benchmark for the total fund shall be determined as a weighted average of the performance benchmarks for each asset class. The Board shall use the asset allocation target weights for the purpose of calculating the performance benchmark for the total fund.

**C. Performance Benchmarks for Each Asset Class**

A standardized measurement has been chosen upon which to judge the long-term performance of each asset class. For performance measurement purposes, long term refers to three and five year rolling periods. Performance of each class should meet or exceed the standard measure.

The current long-term performance measures for each asset class shall be as follows:

<b>Asset Class</b>	<b>Measure</b>
U.S. Equity	Russell 3000 Index
Non-U.S. Equity	Morgan Stanley Capital International – All Country World Free ex-U.S. Index – 50% hedged for developed countries
Private Equity*	Standard & Poor 500 Composite Index plus 3% per annum
Fixed-Income	Lehman Brothers Aggregate Bond Index
Real Estate*	Custom Benchmark **
Cash Equivalents	30-day U.S. Treasury Bills return

\* Returns for private real estate and private equity are reported one quarter in arrears.

\*\* Beginning July 1, 2002, SERS' real estate benchmark is a blended benchmark of 20% NAREIT Equity Index and 80% NCREIF Property Index (one quarter in arrears). Prior to July 1, 2002, SERS' real estate benchmark was the NCREIF Property Index (one quarter in arrears).

#### **D. Performance Benchmark for Each Investment Manager**

Investment Managers have specific performance benchmarks against which their performance shall be measured. In addition to exceeding the performance benchmark, the Investment Manager's performance shall also be measured relative to its peer group. As with the performance for the total fund and for each asset class, the performance of each Investment Manager is measured over annual and rolling three-year and five-year periods.

#### **V. Review and Evaluation**

The Board shall review and evaluate periodic reports on the investment results of SERS' assets. In these reviews, it is intended that greater emphasis shall be given to longer-term results (three to five years) than to shorter-term results. The following is the intended frequency for review and evaluation, although the Board, as deemed necessary, may alter the frequency:

1. Monthly - Investment Report which will include the total fund market value, asset allocation of the fund, the performance of the total fund and each asset class, and each Investment Manager's compliance with Board Policy and Guidelines. This report will be given by Investment Staff.
2. Quarterly - Summary Investment Reports including highlights and commentary of investment performance, asset composition for each asset class and each investment management accountability unit. These reports shall identify any results requiring the attention of the Board. This report will be given by the Board's Investment Consultant.
3. Quarterly and Annual – Investment Manager updates – At least quarterly Investment Staff will discuss the portfolio with each of SERS' Investment Managers. On a periodic schedule, usually once every 12 to 18 months, each Investment Manager will meet with Staff in Columbus; and then Staff will meet with each Investment Manager in its office six to nine months later to monitor each Investment Manager's organization, personnel and performance. Periodically, usually once a year, Investment Staff will prepare a written evaluation of each Investment Manager for the Board.