



**pennsylvania**  
STATE EMPLOYEES' RETIREMENT SYSTEM

**Commonwealth of Pennsylvania  
State Employees' Retirement Board  
Statement of Investment Policy**

**Adopted April 21, 2004  
Amended October 29, 2014**

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**Commonwealth of Pennsylvania  
State Employees' Retirement Board  
Statement of Investment Policy**

**I. Introduction**

The State Employees' Retirement Fund ("Fund") was established in 1923 by an act of the Pennsylvania legislature. The purpose of the Fund is the accumulation of funds exclusively for the benefit of the members and beneficiaries of members of the State Employees' Retirement System ("SERS" or the "System") for the payment of withdrawal, retirement, disability, and death benefits as provided in Pennsylvania Consolidated Statutes Title 71, Part XXV ("Retirement for State Employees and Officers"). The Fund is under the exclusive control and management of an eleven member Board of Trustees ("Board"). Six members are appointed by the Governor and confirmed by the State Senate to four-year terms. Two members of the Senate are appointed by the President Pro Tempore of the Senate, and two members of the House by the Speaker of the House, and serve on the Board for the duration of the terms for which they were elected. The State Treasurer serves as a member of the Board, ex-officio.

The Statement of Investment Policy (the "Policy") was originally adopted by the Board on September 19, 1979 and was last revised by Board action on April 29, 2009.

**II. Statement of Purpose of Investment Policy**

This document specifically outlines the investment philosophy and practices of SERS and has been developed to serve as the governing policy for the management of the System's assets. The purpose of this Policy is to formalize the Board's investment objectives and policies, and to define the duties and responsibilities of the various individuals and entities involved in the investment process. The assets of SERS will be managed with the primary objectives of the payment of benefit obligations to participants in the plans as well as to maximize return with acceptable risk considerations and sufficient liquidity so that employer contributions can be minimized. Therefore, it is crucial that the Board adopt a long-term plan by which the assets of the System will be managed and enhanced through prudent investments. This Policy is intended to ensure that the level of assets is adequate to cover the accumulated liabilities of the System. This is an official investment policy document of SERS. Deviation from this document is not permitted without explicit written permission, in advance, from the Board.

In developing this Policy, the Board understands and accepts its fiduciary obligations to the members of the System. These obligations are legal in nature, and are outlined in Title 71, Pennsylvania Consolidated Statutes, Section 5931, a copy of which is attached hereto as Appendix I.

**III. Prudent Investor Standard**

The Board's investment authority is governed by the "prudent investor" standard as set forth in Title 71, Pennsylvania Consolidated Statutes, Section 5931(a):

**Control and management of fund.** The members of the board shall be the trustees of the fund. Regardless of any other provision of law governing the investments of funds under the control of an administrative board of the State government, the trustees shall have exclusive control and management of the said fund and full power to invest the same in accordance with the provisions of this section, subject, however, to the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to

speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. The trustees shall have the power to hold, purchase, sell, lend, assign, transfer or dispose of any of the securities and investments in which any of the moneys in the fund shall have been invested as well as of the proceeds of said investments, including any directed commissions which have accrued to the benefit of the fund as a consequence of the investments, and of any moneys belonging to said fund, subject in every case to meeting the standard of prudence set forth in this subsection.

No provision of this Policy shall be construed in contravention of the Board's statutory investment authority found in Title 71, Pennsylvania Consolidated Statutes, Section 5931.

#### **IV. Fiduciary Status, Duties, and Responsibilities of Board, Staff, Investment Advisors, Other Agents, and State Treasurer**

SERS is one of the larger public pension funds in the United States. Due to its size and investment structure, its operational requirements are complex. In order to administer the System and carry out its investment obligations, the Board relies heavily on both staff and external contractors. Because of the number of parties involved, their roles as fiduciaries must be clearly identified. Such identification increases operational efficiency, ensures clear lines of responsibility, and reduces or eliminates duplication of effort.

##### **A. Board of Trustees**

Title 71, Pennsylvania Consolidated Statutes, Section 5931(e) provides, in part, as follows:

The members of the board, employees of the board, and agents thereof shall stand in a fiduciary relationship to the members of the system regarding the investments and disbursements of any of the moneys of the fund and shall not profit either directly or indirectly with respect thereto.

In exercising this fiduciary responsibility, the members of the Board, employees of the Fund, and agents of the Fund are governed by the "prudent investor" standard and the exclusive benefit standard. The exclusive benefit standard requires these parties to act solely within the interests of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries.

The Board may, when possible and consistent with its fiduciary duties imposed by law, including its obligation to invest and manage the Fund for the exclusive benefit of the members of the System, consider whether an investment in any project or business enhances and promotes the general welfare of the Commonwealth and its citizens. Where investment characteristics are equivalent, the Board's policy will favor investments that will have a positive impact on the economy of Pennsylvania.

The members of the Board are responsible as trustees for the proper management of the assets of the Fund. The Board has the responsibility of establishing and maintaining broad policies and objectives for all aspects of the System's operations. Specifically with regard to investments, the Board seeks the recommendations of the staff and consultants prior to taking action. In carrying out these duties, the Board will be responsible for:

1. Reviewing and approving a biennial Strategic Investment Plan that sets forth the direction of the Fund and work plan initiatives for the coming two years. This Strategic Investment Plan shall incorporate long-term allocation ranges to the asset classes.
2. Approving the engagement and termination of investment advisors. Staff and consultants will identify potential candidates. Potential advisors will be evaluated based on their ability to achieve the objectives outlined in the Strategic Investment Plan and their demonstrated experience and expertise for the specific mandate. Board suggestions for potential advisors who meet these criteria will be evaluated by staff and consultants. While individual Board Members may meet with prospective advisors, all group meetings involving a quorum of Board Members for a presentation by prospective advisors shall be through formal Board meetings or Board Committee meetings. Staff and consultants are jointly responsible for carrying out the research and initial due diligence to identify qualified candidates. Staff and consultants are also jointly responsible for performing the on-going monitoring of investment advisors and funds. Lastly, all prospective investment opportunities and/or investment advisor terminations which are recommended to the Board must be supported by a memo from Staff and a memo from the relevant investment consultant.
3. Approving the engagement and termination of consultants.
4. Reviewing the investment performance and risk characteristics of the Fund.
5. Reviewing and approving the Comprehensive Annual Financial Report.
6. Reviewing and approving the annual actuarial report, assumptions and funding level and, reviewing and approving an actuarial experience study that is to be conducted no less than every five years.
7. Reviewing and approving the results of an asset liability study on a periodic basis, but not less than every five years.
8. Reviewing and adopting the proxy voting guidelines.
9. Oversight and monitoring of staff including, but not limited to the hiring of the Chief Investment Officer, the Executive Director, and the Director of Internal Audit.

In discharging these responsibilities, the Board has delegated certain functions to the staff and to various contractors who provide professional services to the Board. All persons who act as agents of the Board shall adhere to the highest standards of professional integrity and honesty.

#### **B. State Employees' Retirement Board Staff**

The Executive Director is responsible for administrative matters relating to the operations of the System. The Chief Investment Officer is charged with the coordination of all investment activities and matters within the System. The Investment Office reports to the Board on emerging trends and issues of concern to public pension funds generally and to the Fund in particular. The Investment Office is responsible to the Board to review and analyze the current investment climate, and to recommend adjustments with respect to this Policy that are appropriate to take optimum advantage of new conditions and strategies as they arise in the market place. To ensure that the goals and objectives of the Board are being fulfilled, the Investment Office also reviews and analyzes the philosophies, policies, and strategies

employed by the investment advisors, evaluating the appropriateness of their decision-making processes and their investment styles in relation to present and projected investment horizons.

The Chief Investment Officer of the System is charged with the following responsibilities:

1. To manage, on a day-to-day basis, the portfolio, its components, and agents;
2. To authorize receipt or payment for the acquisition or disposition of investments;
3. To act as liaison on behalf of the Board with all investment-related contractors;
4. To review and analyze all investment transactions for conformity to certain applicable laws, regulations, each advisor's investment strategy statement, and this Policy;
5. To review investment proposals presented by investment advisors, and where appropriate, summarize and recommend the same for Board consideration;
6. To analyze and summarize for the Board pertinent information from relevant publications, discussions, meetings, and research on current investment related topics;
7. To respond to inquiries from the Board and Pennsylvania Legislature, the membership, the press, other governmental representatives, and the public concerning the investments of the Fund;
8. To institute an Annual Implementation Plan ("AIP") detailing what the Fund will be doing in the next year in order to implement the Strategic Investment Plan. The purpose of the AIP is to report to the Board the status of what was accomplished and what will be accomplished going forward.
9. To prepare the Strategic Investment Plan and perform analysis and recommendations for action to present to the Board for approval and implementation consistent with this Policy and achievement of the Board's investment objectives; and
10. To perform such other duties as may be required to implement this Policy.

### **C. Internal Audit**

The Director of Internal Audit reports functionally to the Audit Committee and administratively to the Executive Director. The internal audit department is independent of the System's operational activity and is responsible for providing objective audit and review services for the entire System, including the Investment Office. Internal audit's services emphasize the promotion of adequate and effective internal controls at a reasonable cost and result in suggested improvements that will lead to economies and efficiencies in the Systems' operations.

With the advent of the Sarbanes-Oxley Act of 2002, the Board recognized the need for, and established an Audit Committee to provide additional oversight relating to the adequacy of internal controls applicable to financial reporting. The Audit Committee will meet quarterly to discuss audit related issues. The Audit Committee, at its discretion, may meet with the Director of Internal Audit in executive session. The Audit Committee may make recommendations for changes in internal controls for consideration by the Board but shall have no policy authority.

#### **D. Investment Advisors**

The Board continually seeks to employ investment advisors that possess superior capabilities in the management of assets of public retirement systems. The Fund has carefully documented its investment processes, including those related to hiring advisors to manage the Fund's investments. Those processes are available for review on the Fund's intranet. Each advisor has full discretion to carry out its investment mandate subject to the investment strategy statement contained in the investment management agreement and will be expected to conduct business on behalf of the System in accordance with the mandate for which they were retained. It is the Board's policy to limit the allocation of Fund investments such that no more than 15% of the total market value of Fund assets should be invested in any one investment product offered by an investment advisor, except where management of such investments is of a passive nature (e.g., index funds). Notwithstanding any of the limitations contained in this section, no liquidation of an investment shall be required solely due to changes in market value.

Each advisor's benchmark will reflect that advisor's particular style or tactical role in SERS' investment process. Each benchmark will be clearly specified, measurable, and replicable. Benchmarks do not have to be published or widely recognized; they may be "customized" for a particular investment style or styles. The benchmark shall be determined in advance of funding by mutual agreement between the advisor, staff, and consultant. In the event of a change in management style, agreed upon change in an advisor's strategy, availability of a better benchmark construction methodology, or changes to or additions in indices, an advisor's benchmark may be modified by mutual consent between the advisor, staff, and consultant. Despite the foregoing, it is recognized that benchmarks in the investment industry may fail to capture the investment nuances of an investment advisor, which leads to tracking error relative to the benchmark.

The Board further requires those public markets investment advisors selected and working on its behalf to perform the following activities:

1. To execute investment decisions that are consistent within the scope of the approved investment guidelines expressed in the respective management agreement and other relevant documents.
2. To execute investment transactions on behalf of the Board in a manner that maximizes the investment value of each transaction from the viewpoint of the Fund, utilizing such brokers and dealers as they deem appropriate to obtain the best execution capabilities and/or valuable information with respect to the economy and the affairs of corporations at the lowest total cost to the Fund.
3. To report to the Board at least quarterly through the Investment Office, with the exact frequency and format of reporting to be determined by the Investment Office, on the composition and relative performance of the investments in their designated portfolios; the economic and investment outlook for the near and long term; significant changes in the portfolio during the preceding period; and the reasons for any significant differences between the performance of their portfolios and the appropriate market indices or metrics.

4. To make themselves available as needed for meetings with the Board, staff, or agents of the Board regarding investment matters.
5. To comply at all times with all laws, regulations, contractual investment guidelines, and reporting requirements as determined by staff.
6. To perform such additional activities as detailed in each advisor's investment management agreement with SERS.

#### **E. General Investment Consultant**

The Board's general investment consultant acts as a fiduciary to the Fund, providing reports to the Board on emerging trends and issues of concern to public pension funds generally and to the Fund in particular. The general investment consultant also analyzes and makes recommendations with respect to the Board's asset allocation and investment structure, policies, the investment advisors' implementation of policy and strategy, the appropriate investment horizon for the Fund given its actuarial characteristics, and provides such other research as may be required from time to time.

In addition to the general investment consultant, the Board may retain other investment consultants as required for specialized needs, such as for particular asset classes or unique investment projects. These specialty consultants will report to the Board on emerging trends and issues that are germane to their respective assignments and that are of concern to public pension funds generally and to the Fund in particular. Within the scope of their assignments, the specialty consultants will also analyze and make recommendations with respect to this Policy, the investment advisors' implementation of policy and strategy, and provide such other research as may be needed from time to time.

The general and specialty consultants should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the board.

#### **F. Direct Hedge Fund Investment Consultant**

The direct hedge fund investment consultant acts as a fiduciary to the Fund, and will provide non-discretionary direct hedge fund investment consulting services. The hedge fund investment consultant will assist staff in performing due diligence investigations on prospective direct hedge fund investment opportunities; assist staff with identifying and accessing investment opportunities and investment teams; recommend specific hedge fund investments to SERS and maintain a hedge fund manager database. The direct hedge fund investment consultant will also participate in the development and refinement of hedge fund investment policies, objectives, strategies, benchmarking, risk assumptions, and asset mix appropriate for each sub-asset class; as well as perform qualitative and quantitative portfolio oversight procedures and prepare performance measurement. The direct hedge fund investment consultant will make presentations to the Board supporting investment recommendations as they arise. The performance of the direct hedge fund managers will be reviewed quarterly as part of the general consultant's performance report.



The direct hedge fund investment consultant should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the Board.

#### **G. Alternative Investment Consultant**

The alternative investment consultant acts as a fiduciary to the Fund, and will provide non-discretionary alternative investment consulting services. The alternative investment consultant will assist staff in performing due diligence investigations on prospective private equity and private debt investment opportunities; assist staff with identifying and accessing investment opportunities; recommend specific alternative investments to SERS and maintain a deal log of alternative investment opportunities. The alternative investment consultant will also participate in the development and refinement of alternative investment policies, objectives, strategies, benchmarking, risk assumptions, and asset mix appropriate for each sub-asset class; as well as perform qualitative and quantitative portfolio oversight procedures and prepare performance measurement. The alternative investment consultant will make presentations to the Board supporting investment recommendations as they arise, and review performance at least semi-annually.

The alternative investment consultant should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the Board.

#### **H. Real Estate Consultant**

The real estate consultant acts as a fiduciary to the Fund, and will provide non-discretionary real estate investment consulting services. The real estate consultant will assist staff in performing due diligence investigations on prospective real estate opportunities, assist staff with identifying and accessing investment opportunities, recommend specific real estate investments to SERS, and maintain a real estate database. The real estate consultant will also participate in the development and refinement of real estate policies, objectives and strategies, benchmarking, risk assumptions, and asset mix appropriate for each sub-asset class; as well as perform qualitative and quantitative portfolio oversight procedures and prepare performance measurement. The real estate consultant will make presentations to the Board supporting investment recommendations as they arise and review performance at least semi-annually.

The real estate consultant should be free of conflicts of interest or, where they potentially exist, make complete and total disclosure to the Board and obtain pre-clearance from the Board.

#### **I. Portfolio Evaluation Advisor**

The general investment consultant, or another third party approved by the Board as a portfolio evaluation advisor, will provide quarterly investment performance evaluation and analysis to the Board. The portfolio evaluation advisor will provide to the Board comparative performance measurement against appropriate benchmarks, at the total fund, asset class, sub-asset class and advisor levels for all asset classes except real estate and alternative investments.

These benchmarks will be defined and presented in each quarterly performance report. They are hereby incorporated by reference.

## **J. State Treasurer**

The State Treasurer serves as the custodian of the Fund, pursuant to Title 71, Pennsylvania Consolidated Statutes, Section 5931(c). In this capacity, the State Treasurer is responsible for the safe physical custody of investment instruments and the safe custody of any book-entry investment instruments that are held in depositories on behalf of the Commonwealth. As custodian, the State Treasurer is also responsible for preparing and delivering securities for settlement as authorized by the Board, attending to corporate actions, maintaining a book of record for these securities, facilitating an annual examination of these securities and books, and for preparing payment for securities transactions upon presentation of warrants properly signed and authorized. The State Treasurer may enter into a contract with a sub-custodian bank to assist in the execution of these responsibilities.

The State Treasurer is responsible for the temporary investment of cash balances until funds are required to meet disbursements or to acquire investments.

## **K. Actuarial Consultant**

Pursuant to Title 71, Pennsylvania Consolidated Statutes, Section 5902(j), the Board engages an actuary to perform a valuation of the various accounts of SERS on an annual basis within six months of the close of each calendar year. In every fifth year, the Board shall have the actuary conduct an actuarial investigation and evaluation of the system based on data including the mortality, service, and compensation experience provided by the Board annually during the preceding five years concerning the members and beneficiaries.

## **V. Investment Objectives**

The State Employees' Retirement Fund is a mature pension plan. The appropriate investment horizon is intermediate to long-term (five to ten years) with due consideration of the characteristics of the Fund's liabilities and liquidity requirements.

The objectives of the Fund are to provide benefit payments to participants and beneficiaries at the lowest cost to the Commonwealth and to fund the program through a carefully planned and executed investment program.

The Fund seeks to produce the highest return on investment that is consistent with acceptable investment risks and sufficient liquidity that will permit the Fund to meet the System's benefit obligations, and secondarily, control the cost of the Fund to the taxpayers. The investment program is premised on modern portfolio theory. The Board recognizes that many asset classes and investments can have volatile performance and that the Fund may not achieve investment results over shorter time periods. However, over longer time periods, a well-constructed portfolio and mix of asset classes will provide the optimal results.

The Board, with the help of the staff and consultants, is charged with building a portfolio by carefully assessing the risk and return potential of the global capital markets, and making those investments that are institutionally investable and are reasonably expected to contribute to the Fund's long-term objectives and goals.

Consistent with achieving these objectives the Board has established the following goals relative to investment performance:

- Achieve a net total return equivalent to the actuarial interest rate assumption, or preferably, in excess of this rate in order to improve the funded ratio of the Fund through investment earnings and favorably impact future employer and employee contribution rates.
- Achieve a net, total long-term return that meets or exceeds an appropriate, composite Plan benchmark index on a five-to ten-year rolling time horizon. The composite benchmark index will be based on the asset allocation set forth in the Strategic Investment Plan approved by the Board.

#### **A. Rebalancing Policy**

The primary strategic objectives of rebalancing the Fund are to mitigate risk and enhance returns while meeting the liquidity needs of SERS. The specific risk mitigation objective is to keep the asset allocation and overall investment structure of the Fund consistent with the Strategic Investment Plan and the policy asset allocation and asset class goals contained within it. Due to changes in market movements, actual asset class balances will inevitably deviate from target allocations. These deviations cause the Fund to diverge from the asset allocation chosen by the Board and the expected risk and return attributes associated with it. This divergence, or tracking error, heightens the risk that the Fund may not achieve returns sought by the Board at the risk levels they deem prudent. The Investment Office will have authority to rebalance asset class exposures as necessary and prudent pursuant to the rebalancing policy which is incorporated by reference into this policy.

### **VI. Investment Guidelines**

The allocation of funds to various types of investments is of utmost importance in structuring an efficient portfolio designed to meet the Fund's investment objectives. In order to assure the most beneficial allocation of funds, the Board shall, with the advice of SERS' investment staff, consultants, and investment advisors, adopt a Strategic Investment Plan that will be revised and updated periodically but not less than every two years. This plan will set forth the long-term allocation ranges for the asset classes and identify work initiatives to be pursued over the near term. Furthermore, each investment advisor shall abide by specific investment guidelines that will be consistent with this Policy and the Strategic Investment Plan so as to ensure that the Fund's broad investment objectives will be met. The advisors' specific investment guidelines may be amended from time to time by mutual written consent of the staff and the advisor.

If at any time the economic, fiscal, or investment environment should change significantly during the investment horizon, it shall be the duty of the staff, investment advisors, and consultants to so inform the Board and, if warranted, recommend modifications to the Strategic Investment Plan or adjustment to the allocation of investment assets.

In the application and implementation of this Policy and the Strategic Investment Plan, the Chief Investment Officer in consultation with the Board Chairman, has the authority to make investment decisions on behalf of the board in emergency situations. Emergency situations are defined as those that are unforeseeable and in the absence of action taken; the Fund may be adversely impacted. In the event such action is taken, the Board will be apprised as soon as practical, but no later than the next scheduled board meeting.

### **VII. Prohibited Transactions**

Investment advisors are prohibited from entering into any transactions on behalf of the Fund that are not expressly authorized by this Policy or by specific investment advisor guidelines and all applicable laws and regulations. All advisors and consultants shall disclose any and all economic positions that may conflict with SERS' investment objectives and guidelines.

### **VIII. Investment Advisor Evaluations**

The Board endeavors not to make adverse retention decisions about investment advisors based upon performance absent at least three years of performance data, recognizing that investment strategies are best assessed over full market cycles.

The Board's time horizon to review performance trends shall normally be over full market cycles, although the trend in investment experience over other time periods may be judged important. Any extreme or unusual events or trends will be considered when evaluating intermediate and short-term investment results. The Investment Advisor Monitoring Policy has been developed in order to assist staff in applying consistent criteria to evaluate investment advisors.

Notwithstanding the above, the staff will review advisor performance, portfolio positioning, and transactions at least annually.

### **IX. Corporate Governance Standards**

Good corporate governance promotes responsible business practices that serve as an integral component to a corporation's long-term value creation process and are an indispensable element of an effective corporate risk management program.

SERS is committed to improve corporate governance practices of the companies within the SERS portfolio. SERS' involvement includes: the development and periodic updating of the Board approved proxy-voting policy, voting proxies, active participation in groups working to improve and enhance corporate governance practices, and ad hoc responses to important issues that affect the value of the portfolio, such as letters responding to regulatory and legislative proposals.

The proposed updates to the proxy voting policies shall be prepared by the Investment Office and submitted to the Board for approval. In the update of the policies, the Investment Office shall seek to develop best practices. Best practices shall be developed through relationships with groups working to improve and enhance corporate governance practices and input that focuses on improving corporate governance practices from other prominent plan sponsors.

In addition, SERS monitors and, where appropriate, incorporates best corporate governance practice recommendations from organizations into the proxy voting guidelines. As good corporate governance practices are not static, the annual proxy voting modifications are designed to reflect the current trends in the marketplace.

## **A. Proxy Voting Procedures**

Stock proxies are voted in accordance with the following procedures:

1. The custodian bank forwards to SERS' proxy servicer or advisor proxy statements for securities that SERS owns, excluding securities that are on loan, or investments in the form of pooled funds and limited partnerships.
2. SERS' proxy servicer or advisor will vote all proxies in accordance with the Board's proxy voting guidelines, except those where a specific concern has been raised by a Board Member, advisor, consultant, or staff member.
3. The proxy servicer or advisor may also vote any proxy involving other issues essentially the same as those on which the Board's proxy voting guidelines are well defined.
4. With regard to proxies requiring special attention under the Board's proxy voting guidelines, as well as special issues not covered or anticipated by the proxy voting guidelines, proxies and all pertinent reference material shall be sent to the Chief Investment Officer, who will evaluate the issues with respect to the intent of the proxy voting guidelines. On issues not covered by the proxy voting guidelines, controversial, high-profile, and contested change of control issues, the Chief Investment Officer will consult with the Board's chairman to determine how such proxies will be voted. The Chief Investment Officer will then direct the proxy servicer or advisor to vote the proxies accordingly.
5. The Chief Investment Officer shall regularly report to the Board the types of special issues that are being considered or that have been voted by the Chief Investment Officer.
6. The Chief Investment Officer shall cause to be maintained by SERS' proxy servicer, or advisor, a listing of proxy votes cast in a calendar year. This report, along with all individual actions, shall be available for public inspection on SERS' Internet web site.

## **B. Corporate Actions**

The custodian bank has standing instructions to forward notices of all corporate actions received, such as dividends, stock splits, mergers, acquisitions, spin-offs, or class action suits to SERS and/or its investment advisors.

## **X. Trading and Brokerage Practices**

The Board delegates the responsibility for the selection of brokerage firms to its investment advisors, provided the investment advisors select and utilize brokers in accordance with Section IV, D-2 ("best execution") of this Policy. Notwithstanding this practice, the Board reserves the right to enter into brokerage commission recapture programs, and to establish goals for directed commissions provided the advisors' investment processes are not being affected so as to adversely impact the Fund or place the Fund in a disadvantageous position relative to the advisors' other accounts. As such, advisors may be requested to direct a percentage of their brokerage activity on behalf of SERS. The Board will select the

brokerage firms that are designated to receive such directed commissions, and will communicate this information to the advisors.

The Board also seeks to have advisors direct trades through minority owned firms and reserves the right to establish proposed trading targets. However, the responsibility for the selection and use of minority brokerage firms is delegated to the investment advisors.

Finally, all things being equal, the Board seeks to have investment advisors trade through Pennsylvania-based brokers.

Efforts to monitor and control trading costs will be ongoing, and may include the periodic use of formal trading cost analyses.

## **XI. Public Access to Records**

Records of investment transactions are maintained by the System at its office located at 30 North Third Street, Harrisburg, PA 17101. Requests for public inspection or copies of documents that are a matter of public record will be honored in a manner consistent with the Pennsylvania Right-to-Know Law (RTKL), 65 P.S. §§ 101 - 3104, and SERS' Right-To-Know Law Policy regarding the dissemination of public information. Inquiries should be directed to SERS' Right-to-Know Law Open-Records Officer. This Right-to-Know Law Policy is incorporated by reference into this Policy.

## **XII. Procedures for Amending this Policy Statement**

This Policy may be amended from time to time by a majority vote of the Board.

## **XIII. Separate Documents Related to this Policy Statement**

The following documents are incorporated by reference into this Policy and as such are considered part of this Policy as though they were presented in entirety within this Policy:

1. SERS' Strategic Investment Plan  
(adopted by the Board)
2. Public Markets Investment Advisor Investment Strategy Statements  
(negotiated as part of the contracting process after Board appointment)
3. Real Estate Statement of Investment Policy  
(adopted by the Board)
4. Alternative Investments Statement of Investment Policy  
(adopted by the Board)
5. Proxy Voting Guidelines  
(adopted by the Board)
6. Investment Advisor Monitoring Policy  
(reviewed by Board)

7. Right-To-Know Law Policy  
(adopted by the Board)
8. Derivatives Investment Policy Statement  
(reviewed by Board)
9. Portfolio Rebalancing Policy  
(adopted by Board)
10. Advisor, Asset Class, and Fund Benchmarks as reported in the Quarterly Performance Report  
(reviewed by Board)
11. SERS' Securities Litigation Policy  
(adopted by Board)
12. SERS' Securities Lending Policy  
(reviewed by Board)

#### **XIV. Glossary of Terms**

**Asset Allocation** – investment choice made among broad asset classes such as equities, fixed income securities, real estate, etc.

**Asset Liability Study** - a study that examines how well alternative investment strategies (differing asset allocations) address the objectives of a fund, specifically the fund’s “liabilities”. The study acts as a guidepost for the strategic asset allocation.

**Brokerage Commission** – payment for administrative costs of trading securities; the cost for execution.

**Brokerage Commission Recapture** – reimbursement to the Fund for a portion of the fee paid to a broker for executing a trade.

**Comprehensive Annual Financial Report (CAFR)** - a set of U.S. government financial statements comprising the financial report of a state, municipal or other governmental entity that complies with the accounting requirements outlined by the Governmental Accounting Standards Board.

**Corporate Governance** – the procedures by which a corporation conducts its affairs.

**Corpus** –specifically, the investment portfolio of SERS.

**Fiduciary** – a fiduciary is a legal or ethical relationship of trust between two or more parties where one party has undertaken to act for and on behalf of another party in a particular matter in circumstances which give rise to a relationship of trust and confidence.

**Funded Ratio** - the ratio of a pension’s assets to its liabilities. A funded ratio greater than 100% indicates the pension has accumulated more assets than its liabilities. A funded ratio less than 100% indicates the pension does not have enough assets to cover its liabilities.

**Net Total Return** – interest or dividend income plus any realized or unrealized capital gain (or loss) on an investment, net of any capital contributions or distributions from the corpus.

**Proxy** – an instrument empowering an agent to vote for a shareholder.

**Qualitative Oversight** – analysis that evaluates important factors that cannot be precisely measured, e.g., experience, caliber of management, investment philosophy and strategy.

**Quantitative Oversight** – analysis dealing with measurable factors, such as value of securities, the cost of capital, historical and projected patterns of sales, costs, profitability, returns, risk. Used in tandem with qualitative oversight to arrive at sound business and financial judgments.

**Risk** – the uncertainty of outcome or the likelihood of not meeting an objective.

**Sarbanes Oxley Act** - Congress passed the Sarbanes Oxley Act in 2002 that mandated new or enhanced standards for all U.S. public company boards, management and public accounting firms to improve financial disclosures in order to protect investors from the possibility of fraudulent accounting activities by corporations.

**Tracking Error** – the annual standard deviation of an advisor’s performance results from the advisor’s benchmark.



## Appendix I

### **Title 71, Pennsylvania Consolidated Statutes, 5931. Management of fund and accounts.**

**(a) Control and management of fund.--**The members of the board shall be the trustees of the fund. Regardless of any other provision of law governing the investments of funds under the control of an administrative board of the State government, the trustees shall have exclusive control and management of the said fund and full power to invest the same in accordance with the provisions of this section, subject, however, to the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. The trustees shall have the power to hold, purchase, sell, lend, assign, transfer or dispose of any of the securities and investments in which any of the moneys in the fund shall have been invested as well as of the proceeds of said investments, including any directed commissions which have accrued to the benefit of the fund as a consequence of the investments, and of any moneys belonging to said fund, subject in every case to meeting the standard of prudence set forth in this subsection.

**(b) Crediting of interest.--**The board, annually, shall allow the required interest on the mean amount for the preceding year to the credit of each of the accounts. The amount so allowed shall be credited thereto by the board and transferred from the interest reserve account.

**(c) Custodian of fund.--**The State Treasurer shall be the custodian of the fund.

**(d) Payments from fund.--**All payments from the fund shall be made by the State Treasurer in accordance with requisitions signed by the secretary of the board, or his designee, and ratified by resolution of the board.

**(e) Fiduciary status of board.--**The members of the board, employees of the board and agents thereof shall stand in a fiduciary relationship to the members of the system regarding the investments and disbursements of any of the moneys of the fund and shall not profit either directly or indirectly with respect thereto. The board may, when possible and consistent with its fiduciary duties imposed by this subsection or other law, including its obligation to invest and manage the fund for the exclusive benefit of the members of the system, consider whether an investment in any project or business enhances and promotes the general welfare of this Commonwealth and its citizens, including, but not limited to, investments that increase and enhance the employment of Commonwealth residents, encourage the construction and retention of adequate housing and stimulate further investment and economic activity in this Commonwealth. The board shall, through the Governor, submit to the General Assembly annually, at the same time the board submits its budget covering administrative expenses, a report identifying the nature and amount of all existing investments made pursuant to this subsection.

**(f) Name for transacting business.--**By the name of "The State Employees' Retirement System" or "The State Employees' Retirement System" all of the business of the system shall be transacted, its fund invested, all requisitions for money drawn and payments made, and all of its cash and securities and other property shall be held, except that, any other law to the contrary notwithstanding, the board may establish a nominee registration procedure for the purpose of registering securities in order to facilitate the purchase, sale or other disposition of securities pursuant to the provisions of this law.

**(g) Deposits in banks and trust companies.--**For the purpose of meeting disbursements for annuities and other payments in excess of the receipts, there shall be kept available by the State Treasurer an amount, not exceeding 10% of the total amount in the fund, on deposit in any bank or banks in this Commonwealth organized under the laws thereof or under the laws of the United States or with any trust company or companies incorporated by any law of this Commonwealth, provided any of such banks or trust companies shall furnish adequate security for said deposit, and provided that the sum so deposited

in any one bank or trust company shall not exceed 25% of the paid-up capital and surplus of said bank or trust company.

**(h) Venture capital, private placement and alternative investments.--**The board in its prudent discretion may make any venture capital investment, private placement investment or other alternative investment of any kind, structure or manner which meets the standard of prudence set forth in subsection (a).

**(i) Vehicles for authorized investments.--**The board in its prudent discretion may make any investments which meet the standard of prudence set forth in subsection (a) by acquiring any type of interest in a business organization existing under the laws of any jurisdiction, provided that, in any such case, the liability of the State Employees' Retirement Fund shall be limited to the amount of its investment.

**(j) Legislative declaration concerning certain authorized investments.--**The General Assembly finds and declares that authorized investments of the fund made by or on behalf of the board under this section whereby the board becomes a joint owner or stockholder in any company, corporation, association or other lawful business organization are outside the scope of the original intent of and therefore do not violate the prohibition set forth in section 8 of Article VIII of the Constitution of Pennsylvania.

(Oct. 7, 1975, P.L.348, No.101, eff. imd.; Mar. 4, 1982, P.L.141, No.45, eff. imd.; June 29, 1984, P.L.450, No.95, eff. imd.; Aug. 5, 1991, P.L.183, No.23, eff. imd.; Apr. 29, 1994, P.L.159, No.29, eff. imd.; Dec. 20, 1995, P.L.689, No.77, eff. imd.; May 17, 2001, P.L.26, No.9, eff. imd.)

**2001 Amendment.** Act 9 amended subsecs. (h), (i) and (j). See section 24 of Act 9 in the appendix to this title for special provisions relating to authorized investments.

**1994 Amendment.** See section 14 of Act 29 in the appendix to this title for special provisions relating to authorized investments of the State Employees' Retirement Board as described in subsec. (i).

**Cross References.** Section 5931 is referred to in section 5102 of this title; section 5611 of Title 53 (Municipalities Generally).



**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Alternative Investments Statement of Investment Policy**

**Adopted April 21, 2004 and  
Amended October 29, 2014**

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**Commonwealth of Pennsylvania**  
**State Employees' Retirement System**  
**Alternative Investments Statement of Investment Policy**

Pursuant to Title 71, Section 5931, the Board of the Pennsylvania State Employees' Retirement System ("SERS") establishes this Alternative Investments Statement of Investment Policy (the "Policy Statement") that sets forth the long-term objectives and policies for managing Alternative Investments. The Policy Statement ensures that managers, advisors, and other participants selected by the Board adhere to the investment principles and guidelines of SERS. Additionally, the use of the Policy Statement assures sufficient flexibility in managing investment risks and returns associated with Alternative Investments. The Board may provide for exceptions, or amend this Policy Statement, in whole or in part.

**I. Introduction**

Alternative Investments are largely comprised of non-traditional investments made in limited partnerships organized to make domestic and international private market investments such as venture capital, leveraged buyouts, distressed debt, and special situations acquired in primary or secondary markets. Venture capital investments generally involve the financing of young, non-public growth companies. These investments are made in: (i) seed stage companies in their conceptual phase, (ii) early stage companies after a product has been developed but before revenues are realized, and (iii) late stage companies with demonstrable revenue and attraction for strategic sale or initial public offering of stock. The term "private equity" is employed to describe private market investments in the equity and subordinated debt of established companies.

The members of the Board, employees of the State Employees' Retirement Fund ("Fund"), and its agents shall stand in a fiduciary relationship to the members of the System within the constraints of the "prudent investor" standard.

**II. Investment Objectives**

Alternative Investments are expected to provide return premiums over publicly traded securities, improve the Fund's diversification, and enhance the Fund's asset base over long periods of time. SERS' long-term performance objective for Alternative Investments is to achieve a risk-adjusted return, net of fees, in excess of the 10-year average annualized return of the Russell 3000 Index plus a 300 basis point risk premium.

**III. Asset Allocation**

Asset allocation is a critical driver of the long-term success of Alternative Investments. Since it is not possible to rebalance quickly in Alternative Investments, pacing and manager selection have heightened

importance as tools to influence allocation. Long-term asset allocation targets are established in the Strategic Investment Plan.

Fund investments should be planned and executed in a manner that adheres to the asset allocation targets (transitional and long-term) specified for Alternative Investments in SERS' Strategic Investment Plan. These targets are combined with the targets for global public equity and expressed as a desired asset allocation range, for all of SERS' equity-like investments titled "Total Equity", rather than using discrete percentages. By allowing acceptable allocation ranges, the Fund is not forced to constantly rebalance its assets thus improving the Fund's operational efficiency. Likewise, commitments to the alternative investments asset class may exceed carrying values since committed capital is typically drawn down over a long time period. During this period, some investments will be realized, resulting in distributions of capital back to SERS.

#### **IV. Pacing**

SERS' Strategic Investment Plan may recommend annual commitment ranges to be made by the Fund within each strategy as well as a total target commitment for the Fund (the "Pacing Analysis") in order to achieve both the target strategic allocation and the overall allocation to the Alternative Investments asset class. The Pacing Analysis shall take into account the Fund's overall allocation to and investments in the Alternative Investments asset class, within each strategy, across industries and geography, and by vintage year as well as the market environment and such other considerations as are appropriate. The Fund shall strive to avoid concentrations in strategies, industries, geographic areas, funds, managers, or vintage years.

#### **V. Investment Guidelines**

In an attempt to control the risks inherent in Alternative Investments, SERS strives to invest with alternative investment managers capable of attaining SERS' long-term investment objectives. Selection shall be predicated upon a comprehensive review of each prospective investment manager's ("Manager" or "Firm") current abilities and investment track record to determine if the investment return objectives, as articulated in SERS' Strategic Investment Plan, can be achieved. Collectively, these Fund investments will be broadly diversified in terms of vintage year, industry focus, geographic focus, venture capital stage (e.g., seed, early, growth, or later stage), and private equity focus (e.g., buyouts, distressed, secondaries or other). Exposure to Pennsylvania-based managers may be a component of SERS' Alternative Investments program if achieved within the fiduciary constraints of the "prudent investor" standard. SERS may invest in "fund-of-funds", separately managed accounts, or other vehicle, if by doing so, SERS achieves access to opportunities and/or investment information that might not otherwise be directly attainable in a more efficient or effective manner.

Alternative Investments shall satisfy the following minimum criteria:

## **1. Investment Strategy**

The investment strategy must target investments that satisfy SERS' definition of Alternative Investments. There must be a sufficient universe of potential investments to accommodate institutional investing. The investment strategy must be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of investment concept, and comprehensive analysis of risk factors. The investment strategy shall also outline the Firm's corporate governance policies and procedures with respect to management of the Firm and its underlying investments. Finally, there must be sound evidence that the investment will provide reasonable probability of achieving the return and risk objectives of SERS.

## **2. Investment Process**

The Firm shall demonstrate a sound process for sourcing, performing due diligence, selecting, monitoring, and exiting investments. The investment process shall describe the Firm's internal investment and management controls. The process should also provide for regular monitoring and valuing of existing investments, as well as a strategy and procedure for exiting investments. The Fund has carefully documented its investment processes, including those related to hiring advisors to manage the Fund's investments. Those processes and due diligence tools are available for review on the Fund's intranet at <http://employee.sers.pa.gov/investments.aspx#policies> and are incorporated by reference into this policy.

## **3. Management**

The Manager must have expertise and experience in sourcing, pricing, selection, structuring and negotiating alternative investments. It is preferable that key investment personnel have direct experience investing for institutional investors, a history of working together, a successful track record of implementing the strategy proposed for this investment, and managing portfolios of capital similar in size to the amount currently sought. Depending on the strategy, operational experience in target industries is desirable.

## **4. Terms and Conditions**

Each partnership agreement shall be negotiated such that SERS receives competitive terms and conditions. SERS' leverage to negotiate terms may be reduced when it commits relatively modest capital or if the Firm's offering is heavily oversubscribed.

## **IV. Risk Management**

SERS will seek to minimize risk through investment due diligence and portfolio diversification. Before

any investment is recommended to the Board and an investment is made by SERS, the Investment Staff and/or its Alternative Investments consultant will diligently review the investment opportunity. A due diligence review by the staff and/or Alternative Investments consultant shall include meetings with the investment principals, reviews of pertinent offering documents and supporting materials, the Manager's completion of a due diligence questionnaire, and reference checks. Such reviews will attempt to evaluate the soundness of the investment opportunity and its adherence to SERS' investment guidelines (listed above) as to investment strategy, process, management, and terms and conditions.

SERS will also seek to minimize risk within its Alternative Investment portfolio by diversifying its investments. Diversification will be achieved by investing with managers in funds with differing vintage years, industry focuses, geographic focuses, venture capital stages, and private equity focuses. In addition, individual funds will be diversified by limiting the amount of capital that can be invested in any one company.

## **V. Manager Monitoring and Evaluation**

Each Manager will provide SERS' Investment Office with quarterly unaudited reports (or semi-annual reports if customarily produced by the Manager) and annual audited reports in sufficient detail to allow SERS' Investment Staff to assess performance of each Alternative Investment. Each Manager is expected to report on a timely basis all material developments including, but not limited to, personnel changes, contractual problems or amendments, distribution issues and other items required for appropriate monitoring by the SERS Alternative Investment staff. Each Manager, as part of its investment report to SERS, is expected to provide information concerning Pennsylvania portfolio activity, including employment statistics.

Semiannually, the Alternative Investment consultant will submit to the Board an Alternative Investment performance report. Performance measurement will utilize an Internal Rate of Return metric ("IRR"). The IRR is based on inflows and outflows of partnership capital, giving consideration to the residual value of investment holdings, and calculated net of management fees, expenses, and the Manager's share of carried interest. The IRR calculation is an annualized since inception measure, updated quarterly, and along with cash-on-cash return multiples, shall serve as the primary objective measurement of a Manager's performance. The performance of each investment will be compared against Burgiss' relevant Vintage Year Median Returns (or other relevant relative return data made available by SERS' Alternative Investment consultant).

The Board understands that Alternative Investments are long term in nature, illiquid, and generally involve a duration of 8 to 15 years. Therefore, investment performance must be viewed over a longer time horizon than the assessment period used for publicly traded securities. Although the final performance of an Alternative Investment cannot be known until its termination, it is recognized that performance of a more mature investment (7–10 years) provides a useful indication of its progress.



For SERS' Investment Staff to more actively monitor a Manager's investments for compliance with the terms and provisions of the limited partnership agreement and SERS' expectations, SERS often seeks an advisory board or valuation committee seat. In such capacity, SERS' Investment Staff will generally participate in the review and/or approval of: (i) a Firm's valuation policy, (ii) investments remaining in the portfolio, (iii) the Manager's valuation of such investments, and (iv) whether potential conflicts of interest exist. As the size of SERS' commitments shrinks, it is likely SERS will have fewer opportunities to serve on advisory boards and valuation committees.

## **VI. Separate Documents Incorporated by Reference into this Policy Statement**

- 1. Hiring Investment Advisors**
- 2. Venture Capital/Private Equity Fund Assessment Due Diligence Questionnaire**



**pennsylvania**  
STATE EMPLOYEES' RETIREMENT SYSTEM

**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Real Estate Statement of Investment Policy**

**Adopted April 21, 2004 and  
Amended October 29, 2014**

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**Commonwealth of Pennsylvania**  
**State Employees' Retirement Board**  
**Real Estate Statement of Investment Policy**

Pursuant to Title 71, Section 5931, the Board of Trustees (“Board”) of the Commonwealth of Pennsylvania State Employees’ Retirement System ( the “Fund” or “System”) is establishing this Real Estate Statement of Investment Policy (“Policy”) to set forth the long–term objectives and policies for real estate investments. The Board may amend this Policy Statement in whole or in part or provide for certain exceptions to it.

**I. Introduction**

The Board has determined that, over the long term, inclusion of Real Assets should provide benefits to the Fund’s overall portfolio. The largest component of Real Assets is currently real estate (including timberlands), which is not expected to change over the long run. In real estate, the Board has established the following investment objectives:

1. Generate competitive long-term returns through capital appreciation and current income.
2. Lower overall Fund volatility through diversification to the Fund’s stock and bond portfolios.
3. Provide a moderate hedge against inflation.

In order to achieve these benefits, this Real Estate Statement of Investment Policy establishes the specific objectives and policies required for the implementation and oversight of the Fund’s real estate program. The objectives define the specific risk tolerance and return expectations for the program. The policies provide specifications for acceptable investment styles and management of the various risks associated with the asset class. The members of the board, employees of the board, and agents thereof shall stand in a fiduciary relationship to the members of the System within the constraints of the “prudent investor” standard.

**II. Investment Objectives**

**A. Asset Allocation**

The Board approves a strategic long–term asset allocation target for Real Assets annually as part of the Strategic Investment Plan that is based on analysis of the overall long– term opportunities. . SERS’ Investment Office and Board will undertake an analysis to establish the optimal portfolio mix across Real Asset sectors, it is anticipated that a majority of Real Assets will continue to be comprised of real estate given the current exposure and the Board’s historic dedication to real estate investing.

**B. Return Objective**

The Fund’s performance objective for real estate is to produce a total return, net of managers’ fees,

that exceeds a custom benchmark for rolling five-year periods. The custom benchmark currently consists of three indices; the NCREIF Fund Index—Open-end Equity, the S&P Citigroup Global Index (public real estate securities), and the NCREIF Timber Sub-Index.

### **III. Investment Policies**

#### **A. Investment Universe**

The universe of investable real estate opportunities for the Fund is large and diverse and is constantly changing. The Fund anticipates that it will invest in, but it will not be limited to, the following sectors:

1. Private market equity and debt investments in real estate and real estate related companies.
2. Public market investments in real estate investment trusts (REITs) and real estate operating companies.
3. Private equity investments in timber and agricultural properties.

#### **B. Portfolio Composition**

Each year, as part of the Strategic Investment Plan, the Board shall approve an optimal portfolio mix across various Real Asset sectors, including public and private real estate, timber and farmland (agricultural properties). Investments will be made within each sector that may cause the composition of Real Assets (and real estate) to vary from the optimal mix approved by the Board or from the composition of an approved benchmark for a particular sector, due to the less liquid nature of most private sector investments, the less frequent valuations, and the generally larger capital commitments to individual investments. These investments will be made for the purpose of causing the sector to achieve superior risk-adjusted returns in order to achieve the program's return objective and the benefits for which the allocation to the asset class was made. Examples of variances from the sector benchmark for private real estate may include property type and location diversification, operating cycle, and leverage. Each sector will be evaluated relative to its benchmark, and the evaluation will include an analysis of the composition of the sector relative to its benchmark.

#### **C. Risk Management**

Investments in real estate have risks, including property-level risks, manager risk, and real estate and capital market risks. The Fund will attempt to mitigate risk in a prudent manner. The following policies have been established to address and manage the risks involved with investing in real estate.

##### **1. Investment Structures**

The Fund recognizes that real estate is an illiquid investment. Vehicles that maximize the Fund's control, including the ability to exit an investment are preferred, but the Fund acknowledges that it may use vehicles with limited control in order to achieve certain goals, such as diversification, access to specialized investments, or manager expertise. Limiting the

exposure to any single investment strategy and/or manager will be used to mitigate the risk associated with reduced investor control. The Fund will use the following investment structures:

**a. Individually Managed Accounts**

The Fund may purchase assets on a wholly owned basis through Individually Managed Account structures. The Individually Managed Account structure is the preferred investment vehicle due to their low cost structure and control features that they provide to SERS, except when pooled investment vehicles offer an identifiable advantage for accessing a particular investment strategy. The Individually Managed Account manager may consider joint venture or co-investment ownership within Individually Managed Account structures.

Individually Managed Accounts are actively managed programs with managers buying and selling investments as market conditions and opportunities dictate. All investments are made within the scope of approved investment guidelines in each manager's respective investment management agreement, as well as this Real Estate Statement of Investment Policy. The size of each individually managed account will be determined with reference to the overall allocation to real estate and the level of purchase and sale activity in any given manager's portfolio.

It is the intent that over the long term each individually managed account be self-funded; i.e., that new acquisitions be funded out of portfolio cash flows and sales proceeds. However, it is recognized that the timing of cash flows in these portfolios is difficult to forecast given the uncertainties and lead time involved with the purchase and sale of commercial real estate investments. In addition, it is understood that commercial real estate investments are stand-alone business entities that may require periodic investment of new cash, some of which may be unanticipated and time sensitive, in order to enhance the value of any given investment and honor legal, health and safety, or other obligations, to which the owner (a SERS controlled entity) is bound. At no time will the total amount funded to any individually managed account exceed the commitment amount plus total capital returned as monitored and reported by the real estate/real asset consultant to the Board.

The Investment Office and Consultant will monitor cash flow projections provided by the managers to ensure that the total real estate portfolio will remain within the allocation ranges provided within the Investment Plan. At no time, however, will an individually managed account manager be required to liquidate investments at inopportune times for the purposes of rebalancing.

**b. Pooled Investment Vehicles**

Investment opportunities may be accessed through the ownership of units or shares of a Pooled Investment Vehicle. Any legally organized vehicle is allowed, including, but not limited to, joint ventures, limited partnerships, public and private real estate investment

trusts, insurance company separate accounts, and limited liability corporations. Preference will be given to those Pooled Investment Vehicle's that offer greater investment and reporting transparency.

## **2. Diversification**

The Fund will seek to diversify its real estate portfolio by the following:

### **a. Risk Strategy**

Traditionally, private equity real estate investments have been categorized by the risk and return features of the underlying properties. SERS recognizes two broad categories: Core investments (operating and substantially leased properties) and other types of real estate investments generally categorized as "Non-Core". Core investments are substantially leased (i.e., 60% or greater leased at time of acquisition) institutional quality, well-located assets in the traditional property types: office, apartment, retail, industrial, and hotel. These properties generally offer relatively high current income returns, and as a result, a greater predictability of returns. The income component typically represents a majority of the expected total return of Core investments.

Non-Core real estate includes a variety of risk and return relationships, property types, and investment vehicles. Non-Core investments offer the opportunity to obtain higher risk-adjusted returns arising from the relatively inefficient real estate markets or real estate capital market imbalances. Non-Core investments generally carry higher risk and expected returns than Core investments. Non-Core includes higher property level risk (leasing, renovation, development or repositioning required); a degree of business or operating risk (e.g., hotels, senior housing, or investments in real estate operating companies); or non-traditional formats or properties (e.g., distressed assets or private to public market arbitrage activities).

SERS anticipates that 25% of its real estate program will remain invested in Core investments.

### **b. Manager**

No single investment manager shall manage more than 25 – 30% of the total real estate allocation determined by the Board. However, there may be instances when the "denominator effect," special situations such as portfolio take-overs and value appreciation of investments, can suddenly cause an "out of balance" situation with regard to any given manager. When this type of situation occurs the Investment Office and real estate consultant will work with the affected manager to bring the portfolio back into balance within a reasonable timeframe.

### **c. Property Type and Property Location**

Diversification by property type and location will be monitored and prudently managed, but the Fund recognizes that its diversification relative to benchmark may vary due to current opportunities available in the market and expectations for optimal risk-adjusted returns going forward. Diversification by geography includes international investments.

### **3. Leverage**

The Fund shall seek to constrain overall leverage within the real estate program to a loan-to-value ratio (“LTV”) of 50% at the time the debt is placed. The LTV ratio in the separate account portfolios shall not exceed 60% at the time that debt is placed. It is understood that market value fluctuations may cause the LTV of all or a component of the program to exceed the limits expressed herein; in such an event, SERS shall not be required to sell investments or pay down debt in order to meet LTV limits expressed herein. The preference is to provide the managers the discretion to use leverage within contractual guidelines, when accretive to returns, without significantly increasing risk; however, debt that is recourse to a separate account will not be permitted unless approved by SERS’ Investment Office.

### **4. Investment Size**

At no time shall the net investment amount in a single property within an Individually Managed Account exceed eight percent (8%) of the net market value of the total Fund’s real estate portfolio at the time of initial investment. Likewise, the Fund’s investment in a single Pooled Investment Vehicle may not exceed eight percent (8%) of the net market value of the real estate portfolio at the time of initial investment.

### **5. Valuation**

All investments in an Individually Managed Account will be independently valued not less than once every three years by a qualified Member Appraisal Institute (MAI) designated appraiser approved by SERS’ Investment Office. During interim periods, the Investment Manager responsible for the investments will perform the valuations. Investments held in Pooled Investment Vehicles shall be valued using the methodology approved with the selection of the Pooled Investment Vehicle.

### **6. Vintage Year Diversification**

SERS’ Investment Office shall prudently monitor and manage the vintage year exposure of the total real estate portfolio, but the Fund recognizes that vintage year exposures will vary due to current opportunities and the expectations for optimal risk-adjusted returns available in the market.

### **7. International Investing**

Targeted international investments totaling up to 20% of the total real estate portfolio shall be permitted as approved by the Board. Incidental non-domestic real estate exposure may exist from Pooled Investment Vehicle investments.



## **D. Investment Manager Selection, Control, and Monitoring**

### **1. Individually Managed Accounts**

The following procedures will be used in the selection and monitoring of investments in Individually Managed Accounts.

#### **a. Manager Selection Process**

- 1) Investment managers (both Individually Managed Account and Pooled Investment Vehicle managers) must have significant and direct experience investing and managing money for institutional investors. The manager must have expertise and experience in pricing, selection, structuring, and negotiating real estate investments. It is preferable that key investment personnel have a successful track record of implementing the strategy proposed for this investment, and managing portfolios of capital similar in size to the amount currently sought. Staff and Consultant shall establish specific qualification criteria, desired levels of competency, and respective evaluation factors consistent with the purpose of each search for an Individually Managed Account manager.
- 2) Staff and Consultant shall meet with, review, and evaluate preferred candidates based upon the established criteria.
- 3) Staff and Consultant shall recommend to the Board in writing the manager or managers to be interviewed and selected by the Board.

#### **b. Control and Monitoring**

- 1) Preliminary Investment Summary  
Individually Managed Account managers shall have full discretion over the acquisition, management, and sale of individual investments. Prior to closing an investment, the manager shall provide a Preliminary Investment Summary to Staff. The preliminary package shall include an analysis of the merits, projected return, and exit strategy for the proposed investment, together with sufficient information for SERS' Investment Office to confirm the proposed investment's consistency with this Real Estate Statement of Investment Policy and the investment manager's guidelines and strategy under its investment management agreement.
- 2) Reporting  
Individually Managed Account managers shall adhere to the most recent version of the Real Estate Information Standards established jointly by the National Council of Real Estate Investment Fiduciaries, the Pension Real Estate Association, and the National Association of Real Estate Investment Managers, as well as, generally accepted accounting principles (GAAP). Managers will submit on an annual basis a third-party audited financial statement of the account managed by the Individually Managed Account manager.

3) Responsible Contracting

Managers of the Fund's wholly-owned assets in Individually Managed Accounts shall support and encourage the engagement of responsible contractors to provide building construction and maintenance services for such assets, subject to adherence to the Fund's fiduciary principles of loyalty, care, skill, prudence, and diligence. In all respects, such managers shall recognize and adhere to the principle that only the involved contractor has control over (1) the means and manner by which the contracted services are provided, and (2) the contractor's labor relation policies.

A responsible contractor is a contractor who, among other things: (1) has the appropriate experience, reputation, employee relations, responsiveness, fees, and dependability to perform required work; and (2) provides workers a fair wage and fair benefits for the required work, based on local market conditions. The utilization of such contractors may add value to the Funds' investments by ensuring that essential building and construction services are provided by adequately trained, experienced, and motivated workers.

The Board recognizes the right, as provided by law, of eligible employees to organize into a union or to not organize into a union, as the employees choose, and encourages contractors providing building construction and management services for the Fund's wholly-owned assets in Individually Managed Accounts to recognize and not impermissibly interfere with the lawful exercise of those rights and, upon a proper request, to bargain in good faith with any such lawfully recognized union.

Managers of the Fund's wholly-owned assets in Individually Managed Accounts and contractors providing building construction and maintenance services for such assets shall comply with applicable federal, state, and local laws, regulations and ordinances, including (but not limited to) those related to insurance, tax withholdings, minimum wage, health and safety, labor, and environmental matters.

With respect to those assets that the Fund does not wholly-own, it is desirable that the entity owning such assets comply with the foregoing policy statement.

4) Budget and Management Plan

Not more than 90 days after the end of the calendar year, Staff and Consultant shall meet with the manager of personnel directly responsible for an Individually Managed Account portfolio and asset management for a review and evaluation of the Manager's Budget and Management Plan, which shall include a summary of the prior year's financial performance, budgeted projections for the ensuing year, and the Manager's current hold/sell recommendation for each property.

## **2. Pooled Investment Vehicles**

The following procedures will be used in the selection and monitoring of investments in Pooled Investment Vehicles.

### **a. Selection Process**

- 1) Subject to the minimum manager criteria stated in subsection D(1)(a)(1) above, Staff and Consultant shall establish qualification criteria consistent with the purpose of the search for each Pooled Investment Vehicle manager.
- 2) Staff and Consultant shall meet with and evaluate preferred candidates based upon the established criteria.
- 3) Staff and Consultant shall recommend to the Board in writing the Pooled Investment Vehicle manager or managers to be interviewed and selected by the Board.

### **b. Closing Process**

Completion of due diligence requires Fund counsel's review of the Pooled Investment Vehicle's formation and associated legal documents.

### **c. Control and Monitoring**

Manager shall provide unaudited quarterly statements and reports and annual audited statements, which comply with generally accepted accounting procedures (GAAP). Annual meetings are typically conducted to discuss important developments regarding investment and management issues.

## **E. Discretionary Authority**

The Board provides complete investment discretion within contractual guidelines to its advisors regarding the acquisition, management, and disposition of real estate holdings.

## **F. Performance Measurement Report**

Consultant shall provide performance measurement reports on a quarterly basis reviewing compliance with the Strategic Investment Plan and this Policy Statement. The report shall also include attributes for both the investment managers and the total portfolio including: income, appreciation, gross and net returns; cash flow; diversification; and comparisons with relevant industry performance indices.