

SAN FRANCISCO CITY & COUNTY EMPLOYEES' RETIREMENT SYSTEM
Investment Policy Statement

**Investment Policy, Objectives
and Guidelines for the
San Francisco City and County
Employees' Retirement System**

Mission Statement

San Francisco City and County Employees' Retirement System is dedicated to securing, protecting and prudently investing the pension Trust assets, administering mandated benefit programs, and providing promised benefits.

March 1997

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Introduction

This document provides a framework for the management of the assets of the San Francisco City and County Employees' Retirement System ("SFERS"). The purpose of the Investment Policy is to assist the Board in effectively supervising and monitoring the assets of SFERS (the "Plan"). Specifically, it will address the following issues:

- The general goals of the investment program;
- The policies and procedures for the management of the investments;
- Specific asset allocations, rebalancing procedures and investment guidelines;
- Performance objectives; and
- Responsible parties.

The Board establishes this investment policy in accordance with applicable Local, State, and Federal laws. The Board members exercise authority and control over the management of the Plan, by setting policy which the Investment Staff executes either internally or through the use of external prudent experts. The Board oversees and guides the Plan subject to the following basic fiduciary responsibilities:

- Solely in the interest of, and for the exclusive purpose of providing benefits to participants and their beneficiaries, minimizing contributions thereto, and defraying reasonable expenses of administering the Plan.
- With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character with like aims.
- Diversify the investments of the Plan so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so. Diversification is applicable to the deployment of the assets as a whole.

This policy statement is designed to allow for sufficient flexibility in the management oversight process to capture investment opportunities as they may occur, while setting forth reasonable parameters to ensure prudence and care in the execution of the investment program.

Policies and Procedures

The policies and procedures of SFERS' investment program are designed to maximize the probability that the investment goals will be fulfilled. Investment policies will evolve as fund conditions change and as investment conditions warrant.

Asset Allocation Policy

SFERS adopts and implements an asset allocation policy that is predicated on a number of factors, including:

- A projection of actuarial assets, liabilities and benefit payments and the cost of contributions;
- Historical and expected long-term capital market risk and return behavior;
- An assessment of future economic conditions, including inflation and interest rate levels; and
- The current and projected funding status of the Plan.

This policy provides for diversification of assets in an effort to maximize the investment return of the Plan consistent with market conditions. Asset allocation modeling identifies asset classes the Plan will utilize and the percentage that each class represents of the total fund. Due to the fluctuation of market values, positioning within a specified range is acceptable and constitutes compliance with the policy. It is anticipated that an extended period of time may be required to fully implement the asset allocation policy, and that periodic revisions will occur. SFERS' Investment Staff and external consultants will monitor and assess the actual asset allocation versus policy and will evaluate any variation deemed significant.

The Board will implement the asset allocation policy through the use of investment managers to invest the assets of their portfolios subject to investment guidelines incorporated into the investment management agreements executed with the Board. When appropriate, passive management strategies will also be utilized.

The long-term asset allocation targets and ranges for the investments of the Plan's assets are shown at Tab 1.

Investment Goals

The Plan's general investment goals are broad in nature. The objective shall be to efficiently allocate and manage the assets dedicated to the payment of Plan benefits and administrative expenses. The following goals, consistent with the above described purpose, are adopted:

- The overall goal of SFERS' investment of assets is to provide System participants with retirement benefits as required by City and County Charter. This will be accomplished through a carefully planned and executed long term investment program.
- SFERS' assets will be managed on a total return basis. While SFERS recognizes the importance of the preservation of capital, it also adheres to the principle that varying degrees of investment risk are generally rewarded with compensating returns.
- On an annualized net-of-fee basis, over a full market cycle, the total portfolio will be expected to:
 1. Produce a total portfolio, long-term real (above inflation) return commensurate with the target asset allocation contained at Tab 1 this document; and,
 2. Exceed the assumed actuarial rate of return over rolling five-year periods; and,
 3. Exceed a weighted index based on its asset allocation policy and component benchmarks over rolling five-year periods by an appropriate amount.
- SFERS' Investment Policy has been designed to produce a total portfolio, long-term real return. Consequently, prudent risk-taking is warranted within the context of overall portfolio diversification to meet this goal. The investment activities are designed and executed in a manner that serves the best interests of the members and beneficiaries of the System.
- All transactions undertaken will be for the sole benefit of SFERS' members and beneficiaries and for the exclusive purpose of providing benefits to them, minimizing contributions to the Fund and defraying reasonable administrative expenses associated with the Plan.
- SFERS has a long-term investment horizon, and utilizes an asset allocation which encompasses a strategic, long-run perspective of capital markets. It is recognized that a strategic long-run asset allocation plan implemented in a consistent and disciplined manner will be the major determinant of the Plan's investment performance.
- Investment recommendations and subsequent actions are expected to comply with "prudent expert" standards.

Manager/Consultant Utilization and Selection

The selection of investment managers and consultants is accomplished in accordance with all applicable Local, State and Federal laws and regulations. Each investment manager and consultant functions under a formal contract which delineates responsibilities and appropriate performance expectations. A formal set of investment guidelines and investment administrative requirements for each investment manager has been established and is provided as an addendum to this document.

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Manager/Consultant Authority

The investment managers shall have designated discretion to direct and manage the investment and reinvestment of assets allocated to their accounts in accordance with this document; applicable Local, State and Federal statutes and regulations; and individual management investment plans and executed contracts.

The Board and Staff will consider the comments and recommendations of consultants in conjunction with other available information in making informed, prudent decisions.

Commission Recapture

SFERS requires that active equity managers direct a specific percentage of brokerage transactions for Plan assets under their management through designated commission recapture brokers. SFERS also encourages its fixed-income managers, on a "best effort" basis, to utilize the services of designated commission recapture brokerage firms. It is understood that the commission recapture brokerage firms must provide the best price and execution consistent with market conditions, bearing in mind the best interests of the Fund's beneficiaries and considering all relevant factors.

SFERS will monitor on an ongoing basis the services provided by the commission recapture brokers so as to assure that the investment managers are securing the best execution of SFERS' brokerage transactions.

All rebates or credits from commissions paid by SFERS' investment managers to the commission recapture brokers will be realized in cash and used to reduce the normal investment-oriented operating expenses of the Fund, to acquire investment products or services, or be rebated back to the Fund.

Proxy Voting

SFERS acknowledges that the ownership of equities requires proxies to be voted. The System commits to managing its proxy voting rights with the same care, skill, diligence and prudence as is exercised in managing its other assets. As responsible fiduciaries, the Retirement Board will exercise its proxy voting rights in the sole interest of the System's members and beneficiaries in accordance with all applicable statutes.

The voting rights of individual stocks will be exercised by an assigned proxy provider under the supervision of the Investment Staff consistent with policy direction from the Retirement Board.

Securities Lending

The Board has authorized the execution of a "Security Lending Program" which will be performed by the Plan custodian or qualified third party securities lending agent(s). The program is monitored and reviewed by the Investment Staff and was established by a written agreement authorized by the Board. The income generated by the lending program currently accrues to the Internal Fixed Income account because it has the greatest amount of lendable securities.

Derivatives

Certain of SFERS' investment managers may be permitted under the terms of individual investment guidelines to use derivative instruments to control portfolio risk. Derivatives are contracts or securities whose returns are derived from the returns of other securities, indices or

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instruments including, but not limited to, futures, forwards, options, options on futures and private swaps. Examples of appropriate applications of derivative strategies include hedging interest rate and currency risk, executing a passive management style, maintaining exposure to a desired asset class while effecting asset allocation changes, and adjusting portfolio duration for fixed income.

SFERS' managers are not allowed to utilize derivatives for speculative purposes. In no circumstances can individual managers borrow funds to purchase derivatives. No derivatives positions can be established that create portfolio characteristics outside of portfolio guidelines. Managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

Rebalancing

A systematic rebalancing procedure, implemented quarterly or when significant cash flows occur, will be used to maintain or to move asset allocations within their appropriate ranges. SFERS' Investment Staff will make rebalancing recommendations to the Board.

Portfolio Component Definitions

SFERS will utilize the following portfolio components to fulfill the asset allocation targets and total fund performance goals established elsewhere in this document.

Equities – SFERS anticipates that total returns to equities will be higher than total returns to fixed income securities over the long run, but may be subject to greater volatility. SFERS equity holdings will be well-diversified with respect to capitalization ranges. There are four major equity components in the Plan's asset allocation mix as described below:

- **Core US Stocks** – This segment of the portfolio will provide broadly diversified exposure to the US equity market, primarily through holdings in large and mid-capitalization companies. SFERS will utilize both passive and active investment management in recognition of the high level of market efficiency in this portfolio segment.
- **Value Stocks** – A value stock is defined as one with a high book value (i.e. shareholders' equity per share) relative to its current price. Value stocks are generally more defensive, and have lower betas, higher dividend yields, and lower price/earnings ratios than the market.
- **Growth Stocks** – A growth stock is defined as one with a low book value (i.e. shareholders' equity per share) relative to its current price. Growth stocks generally have expectations of higher growth in earnings, higher betas, lower dividend yields, and higher price/earnings ratios than the market.
- **International Stocks** – This portfolio provides access to equity markets outside the US and consequently plays a significant role in diversifying SFERS' domestic equity portfolio. A core international segment will concentrate on larger companies in established non-US equity markets while a small capitalization segment will ensure exposure to the smaller companies in these established markets. Both passive and active management may be used in the core international equity portfolio. An emerging markets segment further diversifies the established market segments by investing in developing markets which have lower correlations with developed economies. Although considerably more volatile than the other international portfolios, the emerging markets segment also provides significant return opportunities.

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Fixed Income – The primary role of the fixed income portfolio is to provide a stable investment return and to generate income while diversifying SFERS' investment portfolio. The fixed income holdings are comprised of four segments:

- **Core US Bonds** – This portfolio will provide core exposure to the entire US fixed income market (maturities from 1 to 30 years) including US Treasury and US government agency bonds, corporate debt, mortgages and asset-backed securities. The portfolios will be composed generally of investment grade issues and will be managed by both external and internal managers.
- **Commercial Mortgages** – The commercial mortgage portfolio is invested in mortgages backed by real property assets which provide higher income than the core bond portfolios.
- **High Yield Corporate Bonds** – Since SFERS' fixed income portfolio concentrates on investment grade bonds, high yield bonds provide significant diversification as well as additional return opportunities through higher income with some additional volatility relative to the overall domestic bond market.
- **High Yield Commercial Mortgage-Backed Securities (CMBS)** – The High Yield CMBS portfolio is intended to provide above-mortgage market yield and returns, as well as to diversify the fixed income portfolio.
- **Global Bonds** – To take advantage of mature fixed income markets outside the US, this portfolio will have the flexibility to invest in any established bond market around the world. The portfolio will provide diversification to the US interest rate and inflation cycle, and consequently to SFERS' domestic fixed income portfolio. Currency exposure will be actively managed by the manager(s). The effectiveness of the manager(s) will be assessed against an appropriate global bond index and peer group comparison. In addition, the global bond portfolio will be further diversified by exposure to emerging market debt instruments.

Real Estate – SFERS invests in a variety of real estate commingled funds and separate accounts covering a broad array of property types diversified throughout the US. The portfolio is designed to provide a stable level of income combined with potential for price appreciation, particularly in periods of unexpected inflation. SFERS recognizes the illiquid, long-term nature of its real estate investment portfolio and its role in diversifying the other asset classes.

Alternative Investments – This portfolio is a significant source of investment return which has low correlation with SFERS' other asset classes. The Alternative Investment portfolio will include investments in a variety of commingled/partnership vehicles including, but not limited to, venture capital, buyout, turnaround, mezzanine, distressed security and special equity funds. Like the real estate portfolio, the Alternative Investment portfolio is recognized to be long-term in nature and highly illiquid. Because of their higher risk, alternative investments are expected to provide substantially higher returns than publicly traded equity securities. Alternative Investments also include more conservative but also relatively illiquid investments which derive their returns from owning hard assets such as oil and gas reserves and timberland.

General Investment Objectives and Guidelines

Equity Portfolios

Equity investment managers retained by SFERS will follow specific investment styles and will be evaluated against specific market indices which represent their investment style. In addition, in the case of active managers, investment results may also be compared to returns of a peer group of managers with similar styles. The benchmarks for the various equity portfolios may include the following indices, as well as those proposed by the managers reviewed by the Investment Staff and approved by the Board:

S&P 500 Index
Russell 3000 Index
Russell 1000 Value Index
Russell 1000 Growth Index
Russell 2000 Growth Index
Russell 2000 Value Index
MSCI EAFE Index
FTA World x US "Bottom 10%" Index
MSCI Emerging Markets Free Index

General equity guidelines for active managers include the following.

- Managers shall not purchase a company's securities if the holding amounts to more than 5% of the market value of SFERS' assets under a manager's supervision, nor shall SFERS' investment constitute more than 5% of the outstanding voting stock of any stock held by all managers in aggregate. A manager must not allow a position to become more than 10% (at market) of the portfolio without prior written permission of the Investment Staff.
- Unless authorized in guidelines, equity managers' cash holdings shall not breach 5% of portfolio market value.
- American Depositary Receipts (ADRs) listed on a major stock exchange or on the NASDAQ are permitted if specified in the managers' guidelines.
- Convertible securities may be held in equity portfolios and shall be considered equity holdings.
- Securities must be traded on a regulated stock exchange, or listed on the NASDAQ or a comparable foreign market operation.
- Forward or futures contracts for foreign currencies may be entered into for hedging purposes or pending the selection and purchase of suitable investments in or the settlement of any such securities transactions only in international equity portfolios.

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- Restricted transactions include:
 1. The use of borrowed funds.
 2. Short sales or margin sales.
 3. Private placements (except 144As).
 4. Futures, options, currency forwards and futures, and other derivative securities may only be used as specified in each manager's guidelines.

Any exemption from these general guidelines requires prior written approval from the Board.

Fixed Income Portfolios

The internal and external fixed income portfolios will be managed on a total return basis, following specific investment styles and evaluated against specific market indices which represent a specific investment style or market segment. In addition, investment results may also be compared to returns of a peer group of managers investing with a similar style. The benchmarks for the various fixed income portfolios may include the following indices:

Lehman Brothers Aggregate Bond Index
Salomon Brothers High Yield Cash Pay Index
Giliberto-Levy Commercial Mortgage Index
Salomon Brothers World Government Bond Index
J.P. Morgan Emerging Market Bond Index +

General fixed income guidelines for active managers include the following:

- No securities from an individual issuer shall comprise more than 5% of any portfolio based on cost; securities issued or guaranteed by the US government or its agencies are exempt from this limit.
- Unless specified in the guidelines, the minimum average quality rating of any portfolio except the high yield portfolio will be "A" as measured by a major credit rating agency.
- Permissible securities generally include cash equivalents, forward foreign exchange contracts, currency futures, financial futures, government and government agency bonds, Eurobonds, mortgage bonds (including CMOs), commercial mortgages, asset-backed bonds and corporate bonds. Derivatives, including forward or futures contracts for foreign currencies, may generally be used for defensive purposes only, or to effect portfolio management decisions in a timely, cost-effective manner. Borrowed funds shall not be used.

Any exemption from these general guidelines requires prior written approval from the Board.

Investment Management Policy

SFERS will utilize both internally and externally managed portfolios based on specific styles and methodologies. The external managers will be expected to acknowledge in writing they are Plan fiduciaries and will have discretion and authority to determine investment strategy, security selection and timing within their asset class and subject to the Policy guidelines and any other guidelines specific to their portfolio. Performance of the portfolio will be monitored and evaluated on a regular basis relative to each portfolio component's benchmark return and relative to a peer groups of managers with similar investment styles.

Investment managers, as prudent experts, will be expected to know SFERS' policies (as outlined in this document) and any specific guidelines for their portfolios, and to comply with those policies and guidelines. It is each manager's responsibility to identify policies that may have an adverse impact on performance, and to initiate discussion with Staff toward possible improvement of said policies through Board action.

The Board and Staff will also review each investment manager's adherence to its investment policy, and any material changes in the manager's organization (e.g., personnel changes, new business developments, etc.). The investment managers retained by SFERS will be responsible for informing the Board and Staff of all such material changes on a timely basis.

With the exception of the directed brokerage program, investment managers under contract to SFERS shall have discretion to establish and execute transactions with any securities broker/dealers as needed. The investment managers must obtain the best available prices and most favorable executions with respect to all portfolio transactions, as market conditions permit.

The following transactions will be prohibited: short sales; selling on margin; "prohibited transactions" as defined under the Employee Retirement Income Security Act of 1974 (ERISA); transactions that involve a broker acting as a "principal," where such broker is also the investment manager who is making the transaction, and any or all investment activities forbidden by SEC or other applicable governing bodies.

Selection Criteria for Investment Managers

Criteria will be established for each manager search undertaken by SFERS, and will be tailored to SFERS' needs in such a search. In general, eligible managers will possess attributes including, but not limited to, the following:

- The firm must be experienced in managing money for institutional clients in the asset class/product category/investment style specified by SFERS.
- The firm must display a record of stability in retaining and attracting qualified investment professionals, as well as a record of managing asset growth effectively, both in gaining and retaining clients.
- The firm must have an asset base sufficient to accommodate SFERS' portfolio. In general, managers should have at least \$100 million of discretionary institutional assets under management, and SFERS' portfolio should make up no more than 20% of the firm's total asset base. Exceptions shall be made on a case-by-case basis.
- The firm must demonstrate adherence to the investment style sought by SFERS, and adherence to the firm's stated investment discipline.

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- The firm's fees should be competitive with industry standards for the product category.
- The firm must comply with the "Duties of the Investment Managers" outlined herein and conform to AIMR standards for performance reporting.

Criteria for Investment Manager Termination

SFERS reserves the right to terminate an investment manager for any reason. Grounds for investment manager termination may include, but are not limited to, the following:

- Failure to comply with the guidelines agreed upon for management of SFERS' portfolio, including holding any restricted issues.
- Failure to achieve performance objectives specified in the manager's guidelines.
- Significant deviation from the manager's stated investment philosophy and/or process.
- Loss of key personnel or changes in ownership structure.
- Evidence of illegal or unethical behavior by the investment management firm.
- Lack of willingness to cooperate with reasonable requests by SFERS for information, meetings or other material related to its portfolios.
- Loss of confidence by the Board in the investment manager.
- A change in the Fund's asset allocation program which necessitates a shift of assets to another sector.

The presence of any one of these factors will be carefully reviewed by SFERS' Board, but will not necessarily result in an automatic termination.

Duties of Responsible Parties

Duties of the SFERS Board

The Board or its designee(s) will adhere to the following procedures in the management of SFERS' assets:

- The Board develops and approves guidelines for the execution of SFERS' investment program. Only the Board in its sole discretion can delegate its decision-making authority regarding the investment program. Staff will be responsible for the timely implementation and administration of these decisions.
- A formal review of SFERS' investment structure, asset allocation and financial performance will be conducted annually or more frequently as the need arises. The review will include recommended adjustments to the long-term, strategic asset allocation to reflect any changes in applicable regulations, long-term capital market assumptions, actuarial assumptions or SFERS' financial condition.
- The Retirement Board shall review SFERS' investments quarterly¹, or more often as needed, to ensure that policy guidelines continue to be met. The Board shall monitor investment returns on both an absolute basis and relative to appropriate benchmarks and peer group comparisons. The source of information for these reviews shall come from Staff, outside consultants, the custodian and SFERS' investment managers.
- The Board may retain investment consultants to provide such services as conducting performance reviews, asset allocation, manager reviews and investment research. The comments and recommendations of the consultants will be considered in conjunction with other available information to aid the Board in making informed, prudent decisions.
- The Board shall be responsible for taking appropriate action if investment objectives are not being met or if policies and guidelines are not being followed. Reviews for separate portfolios managed by external managers will focus on:
 1. Manager compliance to the Policy guidelines.
 2. Material changes in the managers' organizations, such as investment philosophy, personnel or ownership changes, acquisitions or losses of major accounts, etc. The managers will be responsible for keeping SFERS advised of any material changes in personnel, investment strategy, or other pertinent information potentially affecting performance.
 3. Investment performance relative to each manager's stated performance benchmark(s) as set forth in the manager's investment guidelines.
- The Board shall expect Staff to administer SFERS' investments in a cost-effective manner subject to Board approval. These costs include, but are not limited to, management, consulting and custodial fees, transaction costs and other administrative costs chargeable to SFERS.
- The Board shall be responsible for selecting a qualified custodian with advice from Staff.

¹ Alternative assets are reviewed semi-annually.

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Duties of the Investment Staff

The Retirement Investment Staff, as designated by the Board, plays a significant role in the management and oversight of the Fund. Investment Staff duties include:

- Managing investment funds with similar guidelines as external managers.
- Authority to shift up to 2% of Fund's cash without requiring Board's permission.
- *Monitoring external managers for adherence to appropriate policies and guidelines.*
- Due diligence and oversight of the Real Estate and Alternative Investment portfolios will be conducted by Investment Staff with assistance from its consultants.
- The Investment Staff will be responsible for evaluating and managing the relationships with the consultants to the Fund to ensure that they are providing all the necessary assistance to Staff and the Board as set forth in their service contracts.
- The manager search process will be conducted by Investment Staff, as set forth in this document, with necessary assistance from consultants as directed by the Board.
- Portfolio restructurings resulting from external manager terminations will be managed by Investment Staff with the assistance of consultants and managers, as needed.
- The Investment Staff and its designee(s) shall be responsible for organizing and/or participating in any special research required to manage the Fund more effectively and in response to any questions raised by Board members.
- The Investment Staff shall support the Board in the development and approval of the Investment Plan, implement and monitor the Plan, and report at least monthly on investment activity and matters of significance.
- *The Investment Staff shall ensure that Investment Managers conform to the terms of their contracts and that their performance monitoring systems are sufficient to provide the Board with timely, accurate and useful information.*

Duties of the Investment Managers

The Investment Managers shall:

- Provide the Plan with a written agreement to invest within the guidelines established in the Investment Plan.
- Provide the Plan with proof of liability and fiduciary insurance coverage.
- Be an SEC-Registered Investment Advisor under the 1940 Act, and be recognized as providing demonstrated expertise over a number of years in the management of institutional, tax-exempt assets within a defined investment specialty.

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- Adhere to the investment management style concepts and principles for which they were retained, including, but not limited to, developing portfolio strategy, performing research, developing buy, hold and sell lists, and purchasing and selling securities.
- Execute all transactions for the benefit of the Plan with brokers and dealers qualified to execute institutional orders on an ongoing basis at the best net cost to the Plan, and, where appropriate, facilitate the recapture of commissions on behalf of the Plan.
- Reconcile monthly accounting, transaction and asset summary data with custodian valuations, and communicate and resolve any significant discrepancies with the custodian.
- Maintain frequent and open communication with Staff and the Board on all significant matters pertaining to the Investment Plan, including, but not limited to, the following:
 1. Major changes in the Investment Manager's investment outlook, investment strategy and portfolio structure;
 2. Significant changes in ownership, organizational structure, financial condition or senior personnel;
 3. Any changes in the Portfolio Manager or other personnel assigned to the Plan;
 4. Each significant client which terminates its relationship with the Investment Manager, within 30 days of such termination;
 5. All pertinent issues which the Investment Manager deems to be of significant interest or material importance; and,
 6. Meet with the Board or its designee(s) on an as-needed basis.

Duties of the Master Custodian

The Master Custodian shall be responsible for the following actions:

- Provide complete global custody and depository services for the designated accounts.
- Manage, if directed by the Board, a Short Term Investment Fund (STIF) for investment of any cash not invested by managers, and ensure that all available cash is invested. If the cash reserves are managed externally, full cooperation must be provided to the external cash manager.
- Provide in a timely and effective manner a monthly report of the investment activities implemented by the investment managers.
- Collect all income and principal realizable and properly report it on the periodic statements.
- Provide monthly and fiscal year-end accounting statements for the portfolio, including all transactions; these should be based on accurate security values for both cost and market. These reports should be provided within acceptable time frames.
- Report to SFERS situations where accurate security pricing, valuation and accrued income is either not possible or subject to considerable uncertainty.

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- Provide assistance to the Plan to complete such activities as the annual audit, transaction verification or unique issues as required by the Board.
- Manage a securities lending program to enhance income if directed by the Board. The custodian may also be called upon to manage the cash collateral associated with the securities lending program. If the securities lending program is managed externally, full cooperation must be provided to the external securities lending agent.

Duties of the General Investment Consultants

The General Investment Consultants shall be responsible for the following actions:

- Make recommendations to the Board regarding investment policy and strategic asset allocation.
- Assist SFERS in the selection of qualified investment managers, and assist in the oversight of existing managers, including monitoring changes in personnel, ownership and the investment process.
- Assist in the selection of a qualified custodian (including a securities lending agent and/or a cash manager) if necessary.
- Prepare a quarterly² performance report including performance attribution on SFERS' managers and total assets, including a check on guideline compliance and adherence to investment style and discipline.
- Provide topical research and education on investment subjects that are relevant to SFERS.

Duties of the Real Estate Consultants

The General Investment Consultants shall be responsible for the following actions:

- Make recommendations to the Board regarding investment policy and strategic asset allocation.
- Assist SFERS in the selection of qualified real estate investment managers, and assist in the oversight of existing managers, including monitoring changes in personnel, ownership and the investment process.
- Prepare a quarterly performance report including performance of SFERS' real estate investment managers and total real estate assets, including a check on guideline compliance and adherence to investment style and discipline.
- Provide topical research and education on investment subjects that are relevant to SFERS.

Duties of the Alternative Asset Investment Consultants

²Semi-annual performance report on alternative assets.

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The Alternative Asset Investment Consultants shall be responsible for the following:

- Make recommendations to the Board regarding investment policy and strategic asset allocation.
- Assist SFERS in the selection of qualified alternative asset investment managers, and assist in the oversight of existing managers, including monitoring changes in personnel, ownership and the investment process.
- Prepare a quarterly³ performance report including performance of SFERS' alternative asset managers and total alternative asset holdings, including a check on guideline compliance and adherence to investment style and discipline.
- Provide topical research and education on investment subjects that are relevant to SFERS.

Duties of the Proxy Consultant

- Implement the Retirement Board's policy on voting proxies.
- Prepare a quarterly report document proxy voting activities performed on behalf of SFERS.

³Semi-annual performance report on alternative assets.

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Tab 1

Strategic Asset Allocation with Sub-Asset Classes

<u>Asset Class</u>	<u>Target Percent</u>	<u>Allowable Range⁴</u>
<i>US Stocks</i>	29%	25-33%
Core	8	6-12
Larger Value Orientation	9	7-11
Smaller Value Orientation	5	3-7
Larger Growth Orientation	3	1-5
Smaller Growth Orientation	4	2-6
<i>International Stocks</i>	16%	13-18%
EAFE	10	8-12
Small Cap	3	2-4
Emerging Mkts.	3	2-4
<i>Real Estate</i>	8%	6-10%
<i>Alternative Assets</i>	9%	4-10%
Total Equity	62%	
<i>US Fixed Income</i>	29%	25-33%
Core Bonds	20	18-24
Commercial Mort.	3	2-4
High Yield Corporates	5	3-7
High Yield Commercial MBS	1	0-2
<i>Global Fixed Income</i>	9%	7-11%
Developed Global Debt	8	6-10
Emerging Mkts.	1	0-2%
Total Bonds	38%	

Asset Allocation Targets Approved: February 25, 1997

⁴The ranges for aggregate asset classes are not the sum of their respective sub-asset class ranges.

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Oaktree Capital Management, LLC
High Yield US Fixed Income
Statement of Objectives, Guidelines & Procedures

Investment Approach - High Yield US Fixed Income

Oaktree targets markets that it considers to be inefficient (e.g. high yield fixed income, distressed securities, convertibles). The firm views high yield fixed income investing as the knowing acceptance of credit risk for profit. Oaktree's main source of value added is its focus on minimizing credit losses. The firm characterizes itself as a conservative high yield fixed income investor, and seeks to generate consistent, above average performance results with below-average risk. Portfolio risk is controlled by avoiding high-risk market sectors, performing thorough credit analysis, diversifying over many companies and industries, and concentrating on avoiding losses.

General Guidelines

All investments are subject to compliance with Investment Policies, Objectives and Guidelines for the San Francisco City and County Employees' Retirement System (SFERS). The manager shall construct the portfolio in a diversified and prudent manner. The manager shall invest within the scope of its stated style. The manager shall adhere to the Association for Investment Management and Research's Code of Ethics and the Standards of Professional Conduct as presented in the *Standards of Practice Handbook*.¹

Sector and security selection, portfolio structure and timing of purchase and sales are delegated to the manager subject to the investment management contract. The following transactions are prohibited: short sales, selling on margin, writing options, "prohibited transactions" as defined under the Employee Retirement Income Security Act (ERISA), and transactions that involve a broker acting as a "principal", where such broker is also the investment manager who is making the transaction. Transactions shall be executed on the basis of "best price and execution" for the sole benefit of the San Francisco City and County Employees' Retirement Fund's beneficiaries.

Any material violation of these Investment Manager Guidelines shall be corrected immediately upon detection, and any realized loss resulting from the material violation shall be reimbursed by the manager to SFERS.

Portfolio Guidelines

Industry Limitations	Maximum concentration in any one industry shall not exceed 15% of the portfolio's value
Average Portfolio Credit Quality	B or better
Minimum Issue Credit Quality	CCC by no more than one rating agency ² ; unrated securities which in the judgment of the Manager have credit characteristics that are comparable to rated securities in which the portfolio may invest are also permitted.
Minimum Number of Issuers	75

¹ Association of Investment Management and Research. *Standards of Practice Handbook*. 7th ed. Charlottesville, VA: AIMR, 1996, or successor editions.

² CCC by Standard & Poor's or Caa by Moody's.

San Francisco Employees' Retirement System

Manager Guidelines

Issuer Limits	No more than 5% of the portfolio will be invested in the securities of a single issuer
Private Placements	Private placements are permitted but may not exceed 20% of portfolio market value. This does not pertain to 144A securities or privately-placed securities which can be sold publicly under an effective registration statement.
Zero coupon, deep discount, And payment-in kind bonds	Zero coupon, deep discount (below 80% of par) and payment-in-kind bonds are permitted, but may not exceed 20% of portfolio market value.
Non-North American Issuers	Debt issued by entities domiciled outside of North America is not permitted.
Tobacco-Related Issuers	Purchases of securities of US companies involved in the production of tobacco products are prohibited.

Exceptions to these guidelines will be considered by SFERS on a case-by-case basis, and will require prior written approval from SFERS' Chief Investment Officer.

Authorized Investments

Debt securities such as bonds, notes, mortgages, debentures, etc., including those that are either unrated or have ratings below investment grade.

Securities having equity features such as convertible bonds, preferred stock, warrants, etc., provided that (i) the promised return on such a security is comparable to the yield available on a similar quality, non-convertible bond (i.e., minimal value is given up for the conversion feature) or (ii) the security is relatively minimal in dollar amount and incidental to a high yield bond (i.e., a small amount of common stock or warrants as part of a bond unit) or which is received upon conversion of a convertible security or exercise of a warrant or option received in a reorganization.

Performance Objective

The portfolio's performance objective will be to outperform the Salomon Brothers High Yield Cash-Pay Bond Index (North America) by at least 100 basis points (annualized, net of fees) over a full market cycle (normally defined as 3-5 years)³; and

Perform in the top quartile of a peer group of similar style high yield bond managers over a full market cycle.

³ Performance returns used will be those calculated by SFERS' general investment consultant based on the custodian's market values.

San Francisco Employees' Retirement System
Manager Guidelines

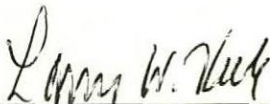
Fees

For asset-based fees, SFERS shall be charged investment advisory fees by the manager which are no higher than those charged to any other endowment fund investment advisory client of the manager under the manager's institutional investor fee schedule for accounts of comparable size and mandate, other than performance fees and reduced fees reflecting settlements for mistakes, errors or misunderstandings.

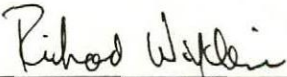
Reporting Requirements

- A. Monthly – Transaction statement, asset (portfolio) statement, and performance for the portfolio and benchmark for the month, including calendar year to date and fiscal year to date, will be sent to the Retirement System and its Investment Consultant by the 20th of the following month.
- B. Quarterly – Same as monthly plus discussion of portfolio's recent strategy and expected future strategy, performance on the portfolio and benchmark for the quarter, year-to-date, 1 year, 3 years, 5 years and since inception. These will be sent to the Retirement System and its Investment Consultant.
- C. Reconcile every month accounting, transaction, and asset summary data with custodian reports and communicate and resolve any significant discrepancies with the custodian. Send a copy of the reconciliation to the Retirement System by the 20th of the following month if there has been a discrepancy.
- D. The manager will meet with Staff and the Board as often as is determined necessary, and should expect to meet with the Board at least annually.
- E. Ensure that all documents, exhibits and written materials that will be used during the meetings between the Retirement Board and the investment manager be submitted to and received by the Retirement System at least seven business days in advance of these meetings.
- F. Provide the Retirement System with proof of liability and fiduciary insurance coverage, in writing, on an annual basis.
- G. The manager will keep the Retirement System apprised of relevant information regarding its organization, senior personnel and investment strategy. The firm will notify the Retirement System within one business day of any change in the lead personnel assigned to manage the account or of any other significant organizational changes or events.

Acknowledged By:

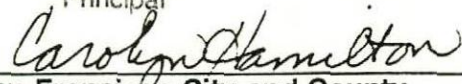


Oaktree Capital Management, LLC
Larry W. Keele
Principal



Richard Wickline
Vice President, Legal

Date: 9/30/98



San Francisco City and County
Employees' Retirement System

Date: 9/28/98

Attachment 1
List of Companies Involved in the Production of Tobacco Products

US Companies

800-JR Cigar, Inc.
Advanced Tobacco Products
Amer Group Ltd.
American Filtrona
American Maize-Products Co.
Brooke Group Ltd.
Brown & Williamson Tobacco Corp.
Caribbean Cigar Co.
Consolidated Cigar Holdings Inc.
Dibrell Bros. Inc.
Dimon Inc.
DNAP Holding Corporation
Fortune Brand, Inc.
Future Brands Inc.
Gallaher Group PLC
General Cigar Holdings, Inc.
Holt's Cigar Holdings, Inc.
Loews Corp
MacAndrews & Forbes Holdings, Inc.
Mafco Consolidated Group
Monk-Austin Inc.
Philip Morris Inc.
Playboy Enterprises, Inc.
Premium Cigars International, Ltd.
RJR Nabisco Holdings Corp.
Standard Commercial Corp
Swisher International Group
Tamboril Cigar Co.
Universal Corp.
UST Inc.