

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.



September 12, 2006

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SAN FRANCISCO CITY & COUNTY EMPLOYEES' RETIREMENT SYSTEM  
INVESTMENT POLICY STATEMENT – SEPTEMBER 12, 2006

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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 to effectively supervise and monitor the assets of SFERS (the "Plan"). Specifically, it will address the following issues:

- The 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 that the Investment Staff executes either internally or through the use of external prudent experts with discretionary authority subject to policies established by SFERS. The Board oversees and guides the Plan and its policies subject to the following basic fiduciary principles:

- To act 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. The Board's duty to its participants and their beneficiaries shall take precedence over any other duty.
- To act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent expert 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.
- To diversify the investments of the Plan so as to effectively trade off the risk of loss and appropriate rates of return. Diversification is applicable to the deployment of the assets as a whole, and does not preclude the use of concentrated investment styles.

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



## INVESTMENT GOALS

SFERS' investment goals are:

- To provide System participants with retirement benefits as required by City and County Charter and applicable laws. 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. Exceed the assumed actuarial rate of return (currently 8.00%) over rolling five-year periods; and/or,
  2. Exceed a weighted index based on its asset allocation policy and respective asset class component benchmarks over rolling five year periods by an appropriate amount.
- To undertake all transactions for the sole benefit of SFERS members and beneficiaries, and for the exclusive purpose of providing benefits to them, minimizing contributions to the Plan and defraying reasonable administrative expenses associated with the Plan.
- To set asset allocation policy in a manner that encompasses a strategic, long-run perspective of capital markets as well as the nature and structure of SFERS' liabilities. SFERS recognizes 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.
- To make decisions and follow investment policies which comply with "prudent expert" standards.



## INVESTMENT POLICIES AND PROCEDURES

The policies and procedures of SFERS' investment program are designed to maximize the probability that the investment goals will be fulfilled.

### 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 and risk tolerance. 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.

Asset allocation policy shall be implemented through the use of investment managers (both internal and external) that will invest SFERS' assets subject to investment guidelines incorporated into the investment management agreements executed with authorized representatives of the System.

SFERS will also use passive management styles in market segments where there is a high degree of market efficiency, where low or no tracking error is desired, or to provide temporary exposure.

The long-term asset allocation targets and ranges for the investments of the Plan's assets are shown in an Appendix at Tab 1. These targets and ranges shall be in effect for both broad asset classes and public market sub-asset classes.



**Investment Manager and Consultant Authority**

The investment managers shall have full discretion to direct and manage the investment and reinvestment of assets allocated to them for management on SFERS' behalf in accordance with this document; applicable Local, State and Federal statutes and regulations; and individual management investment plans and executed contracts.

Consultants shall have no discretionary authority (unless such authority is delegated contractually by the Board and the Consultant), and shall be co-fiduciaries to the Plan. They shall be responsible for making timely and appropriate recommendations on investment policy issues, for monitoring managers, and for reporting on manager and total fund performance on a quarterly basis. 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 use good faith efforts to 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 Plan'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 Plan or to acquire investment products or services, or be rebated back to the Plan.

**Emerging Business Enterprises**

SFERS Staff, its investment managers, and its consultants shall make a good faith effort to retain and utilize the services and/or products of qualified Emerging Business Enterprises on a sub-contracting and/or joint venture basis when those services/products are provided consistent with the fiduciary responsibilities of the Board.

SFERS will also, to the extent possible, use and encourage the use by its managers of brokerage services offered by emerging brokerage firms, particularly certified San Francisco-based firms.

SFERS has also adopted a policy regarding emerging investment managers, which is included as Tab 6 of this document.

**Proxy Voting**

SFERS acknowledges that the ownership of equities requires proxies to be voted, and that such voting rights are a tangible asset of the System. 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, in the sole interest of the System's members and beneficiaries in accordance with all applicable statutes.



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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. The Board shall review the actions of the assigned proxy provider at least annually.

**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 will be monitored and reviewed by the Investment Staff and will be established and governed by a written agreement authorized by the Board. The income generated by the lending program accrues to the account from which assets are loaned.

**Custody of Assets**

With the exception of assets invested in commingled funds, the assets of the Plan shall be held in a custody/record-keeping account in a master custody bank located in a national money center and in the international sub-custodian banks under contract with the custodian bank.

Staff shall be responsible for reviewing the cost-effectiveness and performance of the custodian on a regular basis (at least every five years), with input from SFERS' consultants as needed.

**Derivatives**

Derivatives may be employed by SFERS' investment managers (including internal managers) if permitted in the manager's written guidelines. The purpose of derivatives shall be to control portfolio risk, augment return, and/or execute portfolio strategies in a timely and cost-effective manner. Derivatives are contracts or securities whose returns are derived from the returns of other securities, indices or 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 of fixed income portfolios.

Unless permitted to do so in written guidelines, SFERS' managers are not allowed to utilize derivatives for speculative purposes. SFERS' managers typically shall not borrow funds to purchase derivatives; any exceptions shall be specified in written guidelines applying to the managers. 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 on a regular basis when asset allocation ranges are breached, or when cash flows occur (e.g., for benefit payments or funding new investments), will be used to maintain or to move asset allocations within their appropriate ranges as delineated in Tab 1 of this Investment Policy Statement.

The Deputy Director for Investments (DDI) shall be responsible for undertaking rebalancing at the broad asset class level, and the Senior Investment Officers shall be responsible for making recommendations to the DDI for rebalancing within their respective asset class(es) and for carrying out those recommendations subject to the DDI's approval. Rebalancing decisions will take into consideration a combination of various factors including: cash needed for benefit payments and expenses, cash needed for investments, asset allocation shifts and weights relative to targets and permissible ranges, an assessment of capital markets, and the performance and organizational and investment attributes of individual managers.

When broad asset class ranges are breached, the System will rebalance assets such that asset allocation is brought to within the ranges specified in Tab 1. For sub-asset classes, the (SIOs) will make recommendations regarding allocations to sub asset classes within their area of responsibility, and shall rebalance according to the same rule when relevant ranges are breached. Sub-asset class targets and ranges are also delineated in Tab 1. Subject to approval by the DDI, the Staff will also have discretion on how to redeploy assets within their asset class in accordance with applicable ranges. The Board recognizes that from time to time ranges may be breached for a period of time due to the absence of an appropriate manager and/or Staff judgment that an existing manager(s) should not be allocated additional assets.

The DDI shall report to the Board monthly on the System's rebalancing activities, including any exceptions to policy.

### **Tobacco-Related Holdings**

SFERS does not permit its managers (including internal management) to hold securities of US-based companies involved in the production of tobacco products. This restriction applies to both US equity holdings and to US corporate bond holdings.

The Board will periodically review the impact of this restriction on its overall performance.

### **Asset Class Definitions**

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

**Cash** – Cash will be segmented into two categories:

- **Cash needed for Payment of Benefits and Expenses** – This is cash that will be set aside for the specific purpose of paying benefits and expenses. This cash should generally not be used to meet capital calls or other investment funding requirements. The amount of cash “set aside” for this purpose should not be less than one or more than four months funding requirement, with a target of three months payments. The Custodian will provide performance reporting both including and excluding this cash. However, when evaluating fund performance, particular attention should be paid to the performance **excluding** this cash position





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- **Cash Available for Investment** – This is cash which is available for investment following the Fund's Investment Guidelines contained herein. As a matter of principle, the fund will strive to maintain a “zero cash” policy, i.e., all funds available for investment should be kept invested in accordance with this Investment Policy. Cash Available for Investment should not exceed 1% of Fund assets, with a target of 0%.

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

- **US Equities** – This segment of the portfolio will provide broadly diversified exposure to the US equity market, in both large and small cap market segments, as well as diversified exposure to different style segments (e.g., growth and value). Passive, enhanced passive, and active management strategies will be used in US equity holdings, including internal management by SFERS' Staff. Opportunistic strategies may also be included in the US equity portfolio for the purpose of enhancing return, managing risk, and/or taking advantage of management approaches or hybrid securities that embody equity as well as other characteristics.
- **International Equities** – 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 developed non-US equity markets while a small capitalization segment will ensure exposure to the smaller companies in primarily developed markets. Both passive and active management may be used in the core international equity portfolio, although active strategies will be emphasized. An emerging markets segment further diversifies the developed market segments by investing in developing markets that have lower correlations with developed economies. As specified in their investment guidelines, active managers may be given discretion to hedge currency exposure in their portfolios. The System may retain external experts to provide currency overlay management. Opportunistic strategies may also be included in the international equity portfolio for the purpose of enhancing return, managing risk, and/or taking advantage of management approaches or hybrid securities that embody international equity as well as other characteristics.

**Public Market Fixed Income** – The primary role of the fixed income portfolio is to provide a stable, predictable income while diversifying SFERS' investment portfolio. SFERS fixed income will be well diversified, and may include both investment grade and non-investment grade holdings, US and non-US issues, developed and emerging market debt, mortgage-backed and direct mortgage holdings, and dollar and non-dollar denominated holdings. Internally managed fixed income as well as specialty managers may be utilized. Currency exposure may be actively managed by the System's fixed income manager(s) as specified in the manager's guidelines. Opportunistic strategies may also be included in the fixed income portfolio for the purpose of enhancing return, managing risk, or taking advantage of management approaches or hybrid securities that embody fixed income as well as other characteristics.

A policy framework for Opportunistic Strategies in US equity, International Equity, and Public Market Fixed Income is included at Tab 7 of this Investment Policy Statement.

**Real Estate** – SFERS invests in a variety of real estate commingled funds and separate accounts covering a broad array of property types that are diversified geographically both in the US and internationally. The portfolio is designed to provide return from both income and capital appreciation, and is not correlated with equity markets. SFERS recognizes the illiquid, long-term nature of its real estate portfolio and its role in



providing diversification to the overall portfolio. SFERS has determined that active management will lead to returns that are superior for real estate than passive management strategies. Active management, value creation strategies, and the prudent use of third party debt are approved methods for generating the expected excess return.

The Senior Investment Officer overseeing the Real Estate portfolio, in conjunction with the Real Estate Consultant, will annually update the Strategic Investment Plan for the asset class and submit to the Retirement Board for approval. Additionally, the Senior Investment Officer overseeing the Real Estate portfolio, in conjunction with the Real Estate Consultant, will submit an Annual investment plan to the Retirement Board for its approval at a regularly scheduled meeting. The Annual Investment plan will recap the status of the program and achievement of plan goals, and identify investment initiatives for the following fiscal year. Upon adoption by the Retirement Board, the Strategic and Annual Investment Plans shall become a part of this Investment Policy Statement.

**Alternative Investments** – This portfolio is a significant source of investment return that has low correlation with SFERS' other asset classes. The Alternative Investment portfolio will include investments in a variety of commingled/partnership vehicles including venture capital, buyout, turnaround, mezzanine, distressed security, co-investment and direct investment, and special situations 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 over the long term than publicly traded equity securities. Alternative Investments also include more conservative but also relatively illiquid investments which derive their returns from owning hard and natural resource related assets such as oil- and gas-related properties and timberland.

The primary objective of the Alternative Investment portfolio is to provide a substantial return premium (500 basis points or more) over the S&P 500 Index over rolling 10-year periods. This hurdle will be used to evaluate all alternative investment opportunities. The program will also evaluate opportunities based on whether they diversify the Plan by investment type and by manager to reduce manager and asset-specific risks. A third objective of the program is to reduce total portfolio volatility by investing in assets with a low statistical correlation with public equity markets.

The Senior Investment Officer overseeing the Alternative Investment portfolio, in conjunction with the Alternative Investment Consultant, will annually update the Strategic Investment Plan for the asset class and submit to the Retirement Board for approval. Additionally, the Senior Investment Officer overseeing the Alternative Investment portfolio, in conjunction with the Alternative Investment Consultant, will normally submit an Annual investment plan no later than the November meeting of the Retirement Board for Board approval which will identify investment initiatives for the following calendar year. Upon adoption by the Retirement Board, the Strategic and Annual Investment Plans shall become a part of this Investment Policy Statement.



## GENERAL INVESTMENT OBJECTIVES AND GUIDELINES FOR PUBLIC MARKET SECURITIES

### Public Market Equity Portfolios

Equity investment managers retained by SFERS will follow specific investment styles and will be evaluated against specific market benchmarks that represent their investment style. These indices will be specified in the written investment guidelines governing each portfolio. In the case of active managers where such comparisons are applicable, investment results will also be compared to returns of a peer group of managers with similar styles. These benchmarks may also be modified, as appropriate to the manager's investment style, to exclude tobacco stocks.

General equity guidelines for active managers include the following.

- SFERS' holdings by all managers in aggregate in a single stock shall not constitute more than 5% of the outstanding voting stock of any company.
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- Unless authorized in guidelines, equity managers' cash holdings shall not exceed 5% of portfolio market value.
- American Depositary Receipts (ADRs) or other depository receipts 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 if authorized in guidelines, 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.
- Holdings in US-based companies involved in the production of tobacco products are not permitted.

Any exemption from these general guidelines requires review by the Staff and 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 that represent a specific investment style or market segment. Where applicable, fixed income portfolio investment results will also be compared to returns of a peer group of managers investing with a similar style.

General fixed income guidelines for active managers include the following:

- Permissible securities shall include cash equivalents, forward foreign exchange contracts, currency futures, financial futures, government and government agency bonds, Eurobonds, mortgage backed securities (including collateralized mortgage obligations (CMOs)), commercial mortgages, commercial mortgage-backed securities, asset-backed bonds and corporate bonds (including convertible bonds), or other



securities specifically authorized by the Retirement Board and incorporated in the Manager's Investment Guidelines. If authorized in written guidelines, derivatives, including forward or futures contracts for foreign currencies, may be used to control risk and augment return, or to effect portfolio management decisions in a timely, cost-effective manner.

- Holdings in US-based companies involved in the production of tobacco products are not permitted.

Any exemption from these general guidelines requires review by the Staff and approval from the Board.

## **INVESTMENT MANAGER POLICY**

The selection of investment managers will be accomplished in accordance with all applicable Local, State and Federal laws and regulations. Each investment manager must function under a formal contract that delineates responsibilities, establishes guidelines, and articulates performance expectations.

The investment guidelines and investment administrative requirements for each public market investment manager are included in this document at Tab 4.

Specific policies with respect to managers in non-public market segments are addressed in the Strategic Investment Plans for the Real Estate and Alternative Investments portfolios, included here at Tabs 2 and 3, respectively.

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 each portfolio will be monitored and evaluated on a regular basis relative to its benchmark return and, where appropriate, relative to a peer group 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.

SFERS shall follow the Guidelines for Manager Monitoring and Retention that appears at Tab 6 in evaluating its fixed income and equity managers.

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. SFERS may, at its discretion, prohibit or limit transactions by an investment manager with an affiliated broker/dealer.



### **Selection Criteria for Investment Managers**

Criteria will be established for each manager search undertaken by SFERS, and will be tailored to SFERS' needs in each search.

In general, eligible managers will possess attributes including, but not limited to, the following:

- The firm must be SEC-registered or exempt from registration. Firms claiming exemption from registration requirements must provide appropriate documentation and disclosures indicating reasons for exemption.
- The firm or its senior investment professionals 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, firms should have at least \$250 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.
- 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 CFA Institute/Global Investment Performance Standards (GIPS) standards for performance reporting.

When making a recommendation to retain a manager, any exceptions to these attributes for a recommended manager shall be noted to the Board in writing by Staff or the General Investment Consultant.

### **Criteria for Investment Manager Termination**

SFERS reserves the right to terminate an investment manager at any time for any reason. Guidelines for manager monitoring and retention are included at Tab 6.

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 or Staff in the investment manager.
- A change in the Plan's asset allocation program which necessitates a shift of assets to another sub-asset class or sector.

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

## **DUTIES OF RESPONSIBLE PARTIES**

### **Duties of the SFERS Board**

The Board will adhere to the following procedures in the management of SFERS' assets:

- The Board's primary responsibility is to set the policy framework in which the implementation of SFERS investment program will take place. Staff will be responsible for the timely implementation and administration of the Board's policy decisions.
- The Board shall formally review SFERS' investment structure, asset allocation and financial performance at least every three years, or more frequently should capital markets or the financial condition of the Plan undergo a material, long term change necessitating such a review. 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 Board shall review target allocations and allowable ranges to asset class sub-sectors on an annual basis.
- The Retirement Board shall review SFERS' investment results at least quarterly,<sup>1</sup> 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 and manager reviews, asset allocation, 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. In selecting external consultants, the Board shall consider the recommendations of Staff.
- 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.

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<sup>1</sup> Performance of Alternative assets and equity real estate is reviewed semi-annually.



- The Board shall direct Staff to administer SFERS' investments in a cost-effective manner subject to Board approval. Investment-related 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, and from Consultant(s) if directed by the Staff or the Board.
- The Board shall provide oversight of the effectiveness of Staff's implementation of its policy directives.

### **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 Plan, and is responsible for the timely implementation and administration of the Board's policy decisions. The Board shall monitor the performance of the Investment Staff in carrying out the Staff's duties, which include:

- Managing investment funds according to written investment guidelines as directed by the Board.
- Carrying out rebalancing activity in accordance with the policy stated in this document.
- Monitoring external managers for adherence to SFERS written policies and guidelines, and in accordance with SFERS Manager Monitoring and Retention policy for Equity and Fixed Income. Reviews for separate portfolios managed by external managers will focus on:
  1. Manager compliance with the Policy guidelines.
  2. Managers' compliance with the terms of their contracts, and their ability to provide the System with timely, accurate and useful information.
  3. The manager's ability to continue to achieve its objectives given its investment process and resources.
  4. Material changes in the managers' organizations, such as a material change in investment philosophy, personnel or ownership changes, acquisitions or losses of major accounts, etc. The managers will be responsible for advising SFERS Staff of any material changes in personnel, investment strategy, or other pertinent information potentially affecting performance.
  5. Investment performance relative to each manager's stated performance benchmark(s) as set forth in the manager's investment guidelines as well as the managers' rankings in an appropriate peer group comparison.
- Providing due diligence, oversight, and investment recommendations regarding all investment portfolios, including real estate and alternative investments, with assistance from the respective Consultant(s).
- Evaluating and managing relationships with the Consultants to the Plan to ensure that the Consultants are providing all the necessary assistance to Staff and the Board as set forth in their service contracts and meeting the needs of the System.
- Making recommendations to the Board regarding retention of consultants.
- Conducting manager searches with assistance from Consultants.





- Managing portfolio restructurings resulting from manager terminations with the assistance of consultants, managers, or other parties, as needed.
- Conducting, directing consultants and/or managers to conduct, or participating in any special research required to manage the Plan more effectively and in response to any questions or issues raised by the Retirement Board.
- Reviewing the cost-effectiveness and performance of the custodian on a regular basis (at least every five years), with input from SFERS' consultants as needed or as directed by the Board.
- Monitoring and reviewing the System's securities lending program (if any) on an ongoing basis.
- Monitoring on an ongoing basis the services provided by the commission recapture brokers so as to ensure that the investment managers are securing the best execution of SFERS' brokerage transactions.
- Supporting the Board in the development and approval of the Annual Investment Plan for Real Estate and Alternative Investments, implementing and monitoring the Plan, and reporting at least monthly on investment activity and matters of significance.

#### **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 on an annual basis.
- Be an SEC-Registered Investment Advisor under the 1940 Act or exempt from registration, 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.
- 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 the System 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 client which terminates its relationship with the Investment Manager, and whose assets represent 5% of the firm's AUM or \$100 million, whichever is less, within 30 days of such termination;
5. All pertinent issues which the Investment Manager deems to be of significant interest or material importance to its investment process; and,
6. Meet with the Staff or the Board 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 in this or other fixed income vehicles approved by the Board for this purpose. 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 accounting 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 Staff situations where accurate security pricing, valuation and accrued income is either not possible or subject to considerable uncertainty.
- Provide assistance to the Plan to complete such activities as the annual audit, transaction verification or other unique issues as required by the Board.
- Manage a securities lending program to enhance income if directed to do so 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 Investment Consultants**

The selection of consultants will be accomplished in accordance with all applicable Local, State and Federal laws and regulations. Each consultant shall be a co-fiduciary to the Plan, and must function under a formal contract that delineates responsibilities and appropriate performance expectations.

Consultants shall have no discretionary authority (unless such authority is delegated contractually by the Board and the Consultant). They shall be responsible for making timely and appropriate recommendations on investment policy issues, for monitoring managers, and for reporting on performance results on a quarterly basis. The Board and Staff will consider the comments and recommendations of consultants in conjunction with other available information in making informed, prudent decisions.

Each Consultant shall abide by The Code of Ethics and The Standards of Professional Conduct established by the CFA Institute (formerly the Association for Investment Management and Research) in carrying out its responsibilities with respect to SFERS. The CFAI Code appears at Tab 5.

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

- Make recommendations to the Board and Staff regarding investment policy and strategic asset allocation, including sub-asset class structure.
- Assist SFERS Staff in the selection of qualified investment managers, and make recommendations to the Board and Staff on manager selection.
- Assist Staff in the oversight of existing managers, including monitoring changes in personnel, organization, ownership, the investment process, compliance with guidelines, and other issues likely to affect performance.
- Assist Staff in the selection of a qualified custodian (including a securities lending agent and/or a cash manager) if directed by the Board and Staff.
- Prepare regular performance summaries regarding SFERS' manager, composite, and total plan results and make recommendations addressing any performance issues.
- Provide topical research and education on investment subjects that are relevant to SFERS.
- Other tasks as requested by the Board or Staff consistent with the function served by the General Investment Consultant.

The Real Estate Consultant shall be responsible for the following actions:

- Make recommendations to the Board and SFERS Staff regarding investment policy and strategic asset allocation as they pertain to real estate, and regarding public market securities that are affected by real estate-related issues.
- Assist SFERS Staff in the selection of qualified real estate investment managers, and make recommendations to the full Board on manager selections. This will also include selection of managers of public market securities requiring real estate expertise.
- Assist SFERS Staff in the oversight of existing managers (including any public market securities managers), including monitoring changes in personnel, ownership and the investment process.



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- Prepare a semi-annual 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 real estate investment subjects that are relevant to SFERS.
- Other tasks as requested by the Board or Staff consistent with the function served by the Real Estate Consultant.

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

- Make recommendations to the Board and SFERS Staff regarding investment policy and strategic asset allocation as they pertain to alternative investments.
- Assist SFERS Staff in the selection of qualified alternative asset investment managers, and make recommendations to the full Board for selections requiring Board ratification.
- Assist in the oversight of existing managers (including any public market securities managers), including monitoring changes in personnel, ownership and the investment process.
- Prepare a semi-annual performance report including performance of SFERS' alternative asset managers and total alternative asset holdings, program policy guidelines, and adherence to investment style and discipline.
- Provide topical research and education on investment subjects that are relevant to SFERS, especially those that relate to alternative investments.
- Other tasks as requested by the Board or Staff consistent with the function served by the Alternative Asset Consultant.

**Duties of the Proxy Consultant**

- Make recommendations to the Retirement Board regarding voting of proxies.
- Assist Staff in implementation of the Retirement Board's policy on voting proxies.
- Prepare an annual report documenting proxy voting activities performed on behalf of SFERS.

**Duties of the Performance Measurement Provider**

- The performance measurement provider shall provide regular performance reports including performance attribution on SFERS' managers and total assets, and a check on guideline compliance and adherence to investment style and discipline. Performance calculations shall conform to the CFA Institute's Global Investment Performance Standards (GIPS).



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Tab 1

Strategic Asset Allocation

<u>Asset Class</u>	<u>Target Percent</u>	<u>Allowable Range</u>	<u>Composite Benchmark</u>
US Stocks	28%	22-34%	Russell 3000 Index
International Stocks	20%	16-24%	MSCI ACWI ex. US Index (ND)
<b><i>Total Public Market Equity</i></b>	<b><i>48%</i></b>	<b><i>41-55%</i></b>	
Real Estate	10%	8-13%	NCREIF Property Index
Alternative Assets	12%	9-15%	S&P 500 + 500 bps annualized (long term)
Fixed Income	30%	24-36%	75% LB Universal/25% Global Aggregate Index (Hedged)
Cash	0%	0-1%	90-day Treasury Bills
<b><i>Total Bonds</i></b>	<b><i>30%</i></b>	<b><i>25-35%</i></b>	
<b><i>Total Fund</i></b>	<b><i>N/A</i></b>	<b><i>N/A</i></b>	<b><i>Composite Benchmarks weighted by strategic allocation targets</i></b>

Note: Asset Allocation Targets Approved: July 12, 2005.



**Tab 1 (continued)**  
**Sub-Asset Class Targets**  
**Public Market Equity**

	Target Percent of Asset Class	Sub-Asset Class Minimum	Sub-Asset Class Maximum
<b>US Stocks</b>	<b>100%</b>		
Passive S&P	30%	{ 30% }	{ 60% }
Enhanced S&P	15%		
Passive Large Cap Value	10%	7%	13%
Active Large Cap Value	10%	7%	13%
Active Large Cap Growth	17%	12%	22%
Small Cap Core	1%	0%	3%
Small/MidCap Growth	6%	3%	9%
Small Cap Value	6%	3%	9%
Active Convertibles	5%	0%	10%
US Equity ETF Account	0%	0%	20%
Opportunistic Strategies	0%	0%	5%
<b>International Stocks</b>	<b>100%</b>		
Core/Growth	25%	20%	30%
Core	15%	8%	23%
Growth	6%	3%	9%
Value	30%	24%	36%
Small Cap	12%	7%	17%
Emerging Markets	12%	7%	17%
International Equity ETF Account	0%	0%	20%
Opportunistic Strategies	0%	0%	5%

**Fixed Income**

	Target Percent of Asset Class	Sub-Asset Class Minimum	Sub-Asset Class Maximum
Core US Bonds	14%	10%	25%
Core Plus	30%	20%	40%
Mortgages	10%	7%	13%
High Yield Corporates	6%	4%	8%
High Yield CMBS	8%	5%	11%
Developed Global Bonds	25%	18%	33%
Emerging Market Debt	7%	4%	10%
Opportunistic Strategies	0%	0%	5%

Sub asset class targets approved August 8, 2006.

