

# INVESTMENT POLICY STATEMENT

## MICHIGAN BUREAU OF INVESTMENTS

Effective June 1, 2018

*The Bureau of Investments continually strives to provide quality investment management services, broad professional expertise, and independent advice to the State Treasurer as fiduciary of the State of Michigan Retirement System, and various Michigan trust funds and the State's common cash*

### **I. Introduction**

This Investment Policy Statement (the "Policy") provides the framework for the investing activities carried out by the Michigan Department of Treasury's Bureau of Investments (the "BOI"). Pursuant to state law, the State Treasurer is the custodian and investment fiduciary for each of the systems which comprise the component units of the State of Michigan Retirement System (the "SMRS"): the Michigan Public School Employees' Retirement System; the Michigan State Employees' Retirement System, the Michigan State Police Retirement System; the Michigan Judges Retirement System; and the Military Retirement System; and Other Post-Employment Benefit ("OPEB") funds associated with each component unit. The State Treasurer is also granted custodial and/or fiduciary powers over the assets of various trusts and agency funds of the State of Michigan (the "Trust and Agency Funds") and the common cash fund through legislation. The BOI is vested with the responsibility to invest and manage these assets on behalf and under the direction of the State Treasurer. This authority to act on behalf of the State Treasurer in carrying out investments is grounded in the Public Employee Retirement System Investment Act, 1965 PA 314 ("PA 314"), Section 91 of 1965 PA 380 ("MCL 16.191"), and other applicable laws of this state (with PA 314 and MCL 16.191, the "Authorizing Statutes") and as delegated by this Policy.

Given the nature of its mission, the BOI invests with a long-term horizon in mind. This Policy and its objectives are intended to allow for the BOI to account for the long-term by having sufficient flexibility in the investment management process to take advantage of investment opportunities yet provide parameters that will ensure prudence and care in the execution of the investment program. The State Treasurer and the BOI, as fiduciaries in investing the assets of SMRS and Trust and Agency Funds, shall act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with these matters would use in the conduct of an enterprise with similar aims, in accordance with the Authorizing Statutes, specifically Section 13(3) of PA 314, and other applicable state laws.

The investment divisions of the BOI are generally divided by asset class, subject to necessary revisions by the State Treasurer or Senior Chief Investment Officer (the "CIO") of the BOI, are as follows:

- Domestic Equity Division (DED)
- Fixed Income Division (FID)
- International Equity Division (IED)
- Private Equity Division (PED)
- Real Estate & Infrastructure Division (REID)
- Real Return, Opportunistic and Absolute Return Division (ROAD)
- Venture Capital Division (VCD)
- Defined Contribution, Trusts & Agencies Division (DCTA)

## **II. BOI Structure and Responsibilities**

The State Treasurer and the CIO are authorized to invest the SMRS assets, in accordance with the fiduciary duties established by Public Act 314. Each are also authorized to invest the assets of the Trust and Agency Funds and the common cash fund in accordance with state and federal law, rules, and regulations. The authority to invest the assets of SMRS and the Trust and Agency Funds also includes the power to execute all contracts, agreements, or other such legal documents necessary to effectuate the investment and management of funds, and the authority to delegate all applicable powers and duties to BOI staff, pursuant to all applicable laws and this Policy.

- A. Pursuant to the job specification as set by the Michigan Civil Service Commission (the “Civil Service”), the CIO serves as the senior executive administrator of the BOI and the chief investment officer of the SMRS pension funds, the State’s common cash, and Trust and Agency Funds, reporting directly to the State Treasurer within the Department of Treasury. No other deputy treasurer, senior staff, other employee of the Department of Treasury not employed by the BOI, or employee of any other state agency, unless explicitly stated otherwise under statute or delegated in writing by the State Treasurer, shall be authorized as an investment fiduciary over SMRS funds, Trust and Agency Funds, or the common cash fund. The CIO shall be an appointing authority for the BOI and shall develop and implement the goals for the BOI as well as direct all investment and non-investment operations in compliance with statutory requirements, prudent investment principles, Civil Service rules, sound business practices, and this Policy.
- B. Approval from the State Treasurer is required for investments made by REID, PED, ROAD, or VCD in amounts greater than 1% of the SMRS’ most recent combined quarter-ending Assets Under Management (“AUM”). If the State Treasurer position is vacant, or if the State Treasurer is not available for an extended length of time, the CIO may approve such investment with notice to the State Treasurer as soon as reasonably practicable.
- C. For the SMRS funds, the State Treasurer or the BOI shall report investment returns and strategy quarterly to the Investment Advisory Committee (“IAC”), which reviews the investments, goals, and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The IAC may also, by a majority

vote, direct the State Treasurer to dispose of any holding which in its judgment, is not suitable for the fund involved, and may by a unanimous vote direct the State Treasurer to make specific investments.

1. The IAC acts in an advisory capacity to the State Treasurer and the BOI with respect to the investment and management of the assets of the SMRS, pursuant to the IAC's responsibilities under Michigan statute.
  2. The members of the IAC shall serve without compensation but, as detailed in Section VIII of this Policy, may receive reasonable reimbursement for all actual necessary travel and expenses incurred in the performance of their official duties to attend official IAC meetings only.
  3. Members of the IAC are not permitted to be currently employed by, doing business with, or otherwise receiving compensation from an any entity engaged by the SMRS.
  4. Upon initial appointment to the position, each member of the IAC shall be provided with the following: copies of ethical rules and code of conduct; this Policy; applicable statutes, applicable administrative rules and expectations governing public meetings; and information on any other matters that are central to membership on the IAC. Within 14 days of receiving this information, each IAC member shall certify and sign an attestation of their receipt and acknowledgement of the information. The BOI shall make each certification available for the public via the BOI page on the Department of Treasury website.
- D. The CIO, on behalf of and under the direction of the State Treasurer and with quarterly monitoring by the IAC, shall do the following for SMRS:
1. Conduct, approximately every three years, asset liability studies for the SMRS component units and distribute such studies to IAC members.
  2. Review the fund's long-term asset allocation targets and ranges, which are recorded in a separate document from this Policy (the "Asset Allocation Strategy"), approximately every three years. Tactical shifts in allocations, but within the approved ranges, may be the result of short-term market fluctuations or due to identified market opportunities. An Asset Allocation Strategy remains in effect until a new strategy can be adopted, including if it is determined no changes should be made following a review. However, if changes are deemed prudent following an Asset Allocation review, a revised Asset Allocation Strategy shall be implemented upon the State Treasurer's approval.
  3. Establish delegation of authority and investment responsibility.
- E. The BOI may enter into contracts and pay reasonable compensation for services to investment advisors, consultants, custodians, accountants, auditors, attorneys, actuaries, investment personnel, and administrators, in accordance with applicable state law, prudent business practices, and this Policy.

### III. General Objectives and Policies

The general objectives detailed below define the goals to be achieved through the management of the assets that are subject to this Policy. General policies provide guidelines for the State Treasurer or the BOI, as fiduciaries, to follow in meeting the general objectives.

#### A. General Objectives

1. SMRS: The overall objective of the SMRS is to provide retirement, survivor, and disability benefits to its members through the investment of contributions and other SMRS assets.
  - i. This objective will be attained by following the below principles:
    - (a) Maintain sufficient liquidity to pay benefits.
    - (b) Meet or exceed the actuarial assumption over the long term.
    - (c) Perform in the top half of the public plan universe over the long term.
    - (d) Diversify assets to reduce risk.
    - (e) Exceed individual asset class benchmarks over the long term.
  - ii. The primary investment objective for the SMRS funds is to earn the approved actuarial rate of return on the total investment portfolio over the long term, consistent with a high degree of prudence and sufficient diversity to reduce risk and to meet the actuarial assumption for the investment rate of return, at a reasonable cost. It is understood that to meet the return objective of the fund, investment and equity market risks must be assumed – which in the short term can vary significantly.
2. Trust and Agency Funds: The goals for the Trust and Agency Funds are generally outlined by each fund's authorizing statute; in turn, the investment activities of the State Treasurer and the BOI are centered on generating sufficient returns to allow each fund to fulfill its statutory aims.
  - i. The following principles will be followed:
    - (a) Generate sufficient return to allow the individual trust or fund to fulfill its statutory purpose.
    - (b) Diversify assets to reduce risk.
    - (c) As may be necessary, the BOI may develop and maintain separate investment policy statements specific to a given Trust and Agency Fund.
    - (d) Prudently match liability streams, if applicable.
  - ii. The primary investment object for the Trust & Agency Funds is to earn a rate of return either (i) set by statute or (ii) adopted through policy of a given fund, or

which generally will allow the fund to operate to fulfill its overall purpose. As with the SMRS funds, the Trust & Agency Fund investment returns will be sought at a reasonable cost and achieved by cultivating a motivated team of dedicated professionals. Appropriate investment risks will be taken for each individual trust or fund in light of such trust or fund's specific return objective.

## B. General Policies

1. All transactions undertaken on behalf of (i) SMRS shall be for the sole benefit of plan participants and (ii) the Trust and Agency Funds shall be to fulfill the purpose of the given fund.
2. All BOI personnel involved in the investment process, the State Treasurer and external investment service providers shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, in accordance with Public Act 314, this Policy and any applicable contract.
3. All BOI personnel involved in the investment process, the State Treasurer and external investment service providers shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. These parties are required to reveal all relationships that could create a conflict of interest in their unbiased involvement in the investment process.
4. Investments shall be made without distinction between return generated from income as opposed to capital gains. Diversification, need for liquidity, and the potential for gain and loss will be monitored on an on-going basis.
5. Professional investment management firms, which are registered investment advisors, or which are appropriately exempt from registration under the Investment Advisers Act of 1940, may be retained to assist in managing the assets of SMRS and the Trust and Agency Funds. Investments shall be sufficiently diversified to reduce the risk of material losses from a single investment relative to the size of a particular fund. Each external investment manager will function under a Investment Management Agreement ("IMA") that delineates responsibilities and appropriate performance expectations. Investment guidelines and administrative requirements for management of each portfolio is to be provided to each external manager. BOI investment personnel will review the investment returns of these external managers against stated objectives on a regular basis. Individual external managers will be judged according to benchmarks which reflect the objectives and characteristics of the strategic roles their portfolios are to fulfill. External investment managers are retained to exercise a certain level of discretion over investments, however any action must be taken in accordance with fiduciary duties, state law, this Policy, and the IMA.
6. The BOI, in accordance with this Policy, will allocate contributions within the component units of SMRS on an on-going basis to balance the overall asset allocation

against targets when deviations occur because of capital market fluctuations. Such allocations may be made even if contributions to managers or asset classes have recently experienced poor performance, if investment personnel believe the future outlook to be favorable. If such poor performance is the result of an occurrence other than expected market-related volatility, then a reassessment of that investment shall be undertaken.

7. The BOI may utilize the services of an investment consultant(s) for, among other things, performance review, asset allocation studies, asset liability studies, risk budgeting, manager screening and selection, educational materials, white papers and any other relevant topical studies. The comments and recommendations of the consultant will be considered by the State Treasurer or the BOI, as fiduciaries, in conjunction with other available information for the purpose of making an informed and prudent decision.
8. The BOI will utilize the services of a master custodian bank that will be responsible for the general custody and holding of SMRS' and the Trust and Agency Funds' assets. The BOI may contract with such master custodian bank to deliver related services and products in support of this custodial relationship.
9. The BOI may retain the services of a securities lending provider to generate additional return for SMRS at acceptable levels of risk. The program will be administered in accordance with the securities lending policy negotiated with the provider.
10. The BOI may retain a financial records custodian(s) or administrator, or otherwise contract to access a financial records platform, in order to help efficiently manage the SMRS and Trust Agency Funds private market and public market portfolios.
11. The BOI shall retain the services of a proxy voting agent to vote proxies in accordance with the Bureau of Investments Proxy Voting Policy or other applicable policy.
12. BOI personnel, with assistance from a divestment screening vendor, will monitor SMRS and Trust and Agency Fund investment portfolios for compliance with state divestment statutes that prohibit ownership of securities in companies with active business operations in state sponsors of terror (the "Divestment Act"). When appropriate, and in accordance with applicable law, the BOI will (i) engage those companies that are found to violate the terms of the Divestment Act and (ii) take necessary responsive actions in order to allow the BOI to comply with the Divestment Act.
13. It is the responsibility of the State Treasurer and the BOI to administer the investments of SMRS and the Trust and Agency Funds at reasonable industry standard cost, being careful to avoid sacrificing quality and opportunity for gain. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs, incentive fees and other administrative costs chargeable to SMRS.
14. The CIO shall be required to approve any investment, or any action pursuant to an investment, by SMRS or the Trust and Agency Funds which is outside of the scope of this Policy but which otherwise conforms with all applicable laws.

15. The State Treasurer and the BOI will operate investments of SMRS and the Trust and Agency Funds in compliance with all applicable state and federal, laws and regulations concerning the investment of pension assets.

#### **IV. Goals and Investment Return Objectives**

The investment returns of the fund will be measured against objectives for the total SMRS and component units and against objectives for individual portfolio components (asset classes and individual managers). Investment returns shall be measured against these targets no less than quarterly. Due to the nature of capital markets fluctuations and given the length of the duration of the liability stream, the investment return relative to objectives and goals is to be judged over a period of a market cycle as well as standard annualized periods of one, three, five, seven, and ten years. Greater emphasis is placed on intermediate and long-term results.<sup>1</sup>

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|--------------------------------|---|
| A. <u>SMRS Total Fund</u>      | Exceed the actuarial assumed rate of return.<br><br>Exceed the calculated Policy Benchmark rate of return.<br><br>Rank above median in a public pension plan universe greater than \$10 billion.  |
| B. <u>Domestic Equity</u>      | Exceed the total return of the S&P Composite 1500 index net of fees for one, three, five, seven, and ten-year periods and a market cycle.<br><br>Rank above median in a public plan universe of domestic equity investments.<br><br>Rank above median in a universe of managers possessing a similar market cap and style characteristics.        |
| C. <u>Fixed Income</u>         | Exceed the Bloomberg Barclays U.S. Aggregate Index, net of fees for one, three, five, seven, and ten-year periods and a market cycle.<br><br>Rank above median in a public plan universe of fixed income investments.<br><br>Rank above median in a nationally recognized universe of managers possessing a similar duration and credit exposure. |
| D. <u>International Equity</u> | Exceed the total return of the MSCI ACWI ex USA Index net of fees for one, three, five, seven, and ten-year periods and a market cycle.<br><br>Rank above median in a public plan universe of non-U.S. equity investments.  |

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<sup>1</sup> Peer universes may only be available for these comparisons on a gross-of-fees basis and should be considered when evaluating returns. In addition, benchmark and peer data may change from time to time as markets/industries evolve.

Rank above median in a universe of managers possessing a similar market capitalization, style, and geography characteristics.

E. Private Equity and Venture Capital

Exceed the S&P 500 index by 300 basis points net of fees lagged by three months over one, three, five, seven, and ten-year periods and a market cycle.

Rank above median in a public plan universe of private equity investments.

F. Real Return

Exceed the rate of inflation, as measured by the United States Consumer Price Index (CPI), by 500 basis points annually net of fees over one, three, five, seven, and ten-year periods and a market cycle.

If available, rank above median in a nationally recognized universe of managers possessing a similar style.

G. Opportunistic

Exceed the actuarial rate of return.

H. Absolute Return

Exceed U.S. T-bills by 400 basis points net of fees over one, three, five, seven, and ten-year periods and a market cycle.

Exceed the appropriate HFN Fund of Funds Aggregate Index median net of fees over one, three, five, seven, and ten-year periods and a market cycle.

If available, rank above median in a public plan universe of hedge fund investments.

I. Real Estate & Infrastructure

Exceed the NCREIF Property Index over the one, three, five, seven, and ten-year periods and a market cycle, less 130 basis points.

Meet or exceed the NCREIF Fund Index – Open End Diversified Core Equity (NFI-ODCE) over one, three, five, seven, and ten-year periods and a market cycle.

If available, rank above median in a public plan universe of real estate investments.

**V. General Investment Manager Guidelines and Requirements**

- A. Purchases and sales, security selection, and portfolio implementation of investment strategies may be delegated to the discretion of the investment manager, subject to compliance with SMRS investment policies, individual contracts, and Public Act 314. If



a commingled vehicle or mutual fund is utilized, the investment policies of that fund shall be considered the operative policy document.

- B. Purchases of any securities or execution of any transaction not authorized by Public Act 314 are prohibited.
- C. Transactions shall be executed at a reasonable cost, taking into consideration prevailing market conditions and services and research provided by the executing broker.
- D. All investment managers shall comply with reporting requirements imposed by Public Act 314 or through investment management agreements and side letters
- E. All BOI investment personnel and Department of Technology, Management and Budget (“DTMB”) employees who are subject to the BOI’s Investment Personnel Supplemental Code of Ethics and Standards of Conduct shall annually affirm adherence to Public Act 314; the Standards of Conduct for Public Officers and Employees Act, 1973 PA 196; Michigan Civil Service Rules governing gifts, disclosure, and travel; CFA Institute Code of Ethics and Standards of Professional Conduct; the Michigan Department of Treasury Policy on Ethical Conduct and Supplemental Employment; and the BOI Investment Personnel Supplemental Code of Ethics and Standards of Conduct; the BOI Prohibition of Insider Trading Policy and corresponding Frequently Asked Questions.
- F. Prior to becoming a service provider, investment managers shall certify that no political contributions that violate Section 13e of Public Act 314 have been made to a governmental official who could influence the award of pension contracts and shall agree to inform the State Treasurer if the statement should no longer be accurate.
- G. All investment managers will be expected to provide the BOI, the custodian, and their investment consultant, on a timely basis each quarter, such data as is required for proper monitoring.
- H. The use of index futures, or other derivatives, in accordance with Public Act 314 is permitted.
- I. The REID portfolio may (through various legal structures) invest in properties located inside or outside of the United States through standard industry legal structures. No property may be purchased directly fee simple.
- J. Investment return objectives are to be met on a net-of-fees basis.
- K. Investments that are outside of the scope of the investment guidelines applicable to an investment manager, but otherwise deemed prudent by that investment manager, may be made only upon review and approval by the State Treasurer or by an authorized representative of the State Treasurer.
- L. Investment managers must comply with state laws prohibiting the State Treasurer from investing public monies in companies engaged in active business operations in countries designated as a state sponsor of terror by the United States Department of State. The BOI will provide investment managers with a list of prohibited companies each quarter.

Investment managers must refrain from acquiring securities in companies that appear on the lists and divest if directed by the BOI.

- M. Investment managers and investment service providers must comply with federal and state Pay-to-Play Rules placing limits on political contributions made to governmental officials who could influence the award of investment contracts.

## **VI. Other Policies**

### **A. Prohibition of Insider Trading Policy**

Buying or selling securities while aware of material non-public (“inside”) information concerning the issuer of the securities, or improperly disclosing to others such inside information, may constitute fraud under federal and state securities laws and a violation of other legal and regulatory requirements. Inside information also includes information that any BOI investment personnel, or DTMB affiliate, may have concerning SMRS or Trust and Agency Funds’ securities positions or trading activity.

The BOI has a Prohibition of Insider Trading Policy that provides a process for guarding against violations of state, federal, and foreign securities laws that prohibit insider trading. To this end, the BOI maintains and regularly updates a list of securities that BOI investment personnel and DTMB affiliates may not personally trade because the BOI has identified the securities as inside information. The securities identified as such are listed as restricted in the BOI’s Personal Trade Approval System (“PTAS”). Before any BOI personnel can execute trades for their personal accounts, including those of household members and accounts over which the individual exercises investment discretion, the PTAS must be consulted to see if the security is restricted. This process is intended to prevent misuse of material, nonpublic or inside information. All personal trades must be disclosed quarterly to the BOI’s Chief Compliance Officer. The policy institutes safeguards designed to prevent the sharing of insider information between public and private market investment division investment personnel. All internal portfolios will be managed in compliance with the BOI Prohibition of Insider Trading Policy.

### **B. Proxy Voting Policy**

Active voting of proxies is an integral part of the investment process that serves the interests of shareholders and advances good corporate governance. As such, the State Treasurer or the BOI will timely vote proxies in all shareholder meetings where the SMRS or any other state fund is a shareholder and entitled to vote. In furtherance of this endeavor, the State Treasurer and the BOI has adopted the SMRS Proxy Voting Policy, which is periodically reviewed and revised as needed by the BOI’s Compliance and Corporate Governance Division to reflect changes in state law and best practices in corporate governance. The BOI has retained a proxy voting agent to vote all shareholder ballots in accordance with the Proxy Voting Policy. However, the BOI retains the authority to manually vote any proxies dependent on the facts and circumstances surrounding any particular shareholder vote.

### C. Ethics Policy

BOI personnel and DTMB affiliates are held to the highest ethical standards and must comply with a number of directives aimed at ensuring integrity at the BOI. All BOI personnel and DTMB affiliates must conduct themselves in a way that promotes public confidence BOI and the State Treasurer. The BOI fulfills this directive by following and adhering to ethical guidelines established by the following sources: Public Act 314; Standard of Conduct for Public Officers and Employees; Michigan Civil Service Rules; CFA Institute Code of Ethics and Standards of Professional Conduct; and the BOI Prohibition of Insider Trading Policy. Each year, all BOI personnel and DTMB affiliates must affirm adherence to these policies, statutes, guidelines, and directives by signing an annual affirmation. Violations, or suspected violations, of any of these policies, statutes, guidelines, or directives must be immediately reported to the Deputy Chief Investment Officer or Chief Compliance Officer.

Members of the Investment Advisory Committee, as discussed in more detail above, are also required to certify their receipt of ethical rules and code of conduct.

### D. Divestment Policy

Public Act 314 requires that the State Treasurer quarterly review SMRS internal and external holdings to ensure no public monies are invested in companies engaged in active business operations in any country that is designated as a “State Sponsor of Terror” by the United States Department of State. As described above, the BOI contracts with a third-party vendor that creates lists of scrutinized companies using statutory factors. Consistent with the statute, the BOI engages with companies where the SMRS is a shareholder. If engagement is not successful, then the SMRS must divest its holdings in the company in accordance with a statutory divestment schedule.

## **VII. BOI Travel Authorization**

- A. All BOI personnel travel is required to be for the purposes of investment monitoring, due diligence, or for educational purposes. These purposes are consistent with the obligations of an investment fiduciary and align with the objective to increase state restricted revenues by maximizing investment returns for the SMRS and Trust & Agency Funds.
- B. Travel expenditures for BOI personnel must stay within annual budget allocations for each fiscal year. All BOI travel shall comply with Treasury, DTMB, and Civil Service travel policies and guidelines, and where applicable, investment management and partnership agreements.
- C. The CIO or BOI senior management staff shall review and approve all BOI travel requests. The CIO’s travel and expense reimbursement requests shall be reviewed and approved by the State Treasurer or other designated Department of Treasury staff, which may be approved via email.
- D. Treasury Form 1941, or other applicable form(s), will be completed and maintained by the BOI for out-of-state travel requests, in accordance with Treasury’s or the State’s record retention policy.

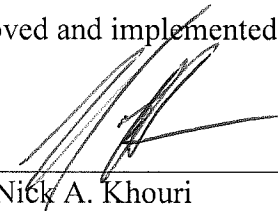
E. IAC members shall not travel on behalf of SMRS for the purpose of conducting investment monitoring or due diligence, or for attending educational seminars, training, conferences or similar events. Except as expressly authorized by MCL 16.191, IAC members shall not receive reimbursement from the BOI for any travel expenses. For clarity, eligible reimbursable expenses shall be restricted to travel expenses incurred in connection with attending quarterly IAC meetings. This prohibition helps ensure unbiased decision making and is intended to prohibit any actual occurrence of conflict of interest by IAC members, who are charged with acting in an advisory capacity only, and to avoid even the appearance of a conflict of interest.

**VIII. Public Posting of Investment Policy Statement**

This Policy shall be made available to the public via the BOI page on the Department of Treasury website.

Approved and implemented:

By:

  
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Nick A. Khouri  
State Treasurer of the State of Michigan

Date:

5/16/18