



FIDUCIARY STANDARD POLICY

PURPOSE

The purpose of this policy is to establish the standard of care to which an investment manager, investment fund, or any other entity or person offering to invest SCERS' assets must agree in writing prior to receiving SCERS assets, or receiving SCERS' commitment to provide assets, for investment.

DEFINITIONS

For purposes of this policy, the following definitions apply:

"Preferred Fiduciary Standard of Care" means the standard of care set forth in the California Constitution, Article XVI, Section 17 and California Government Code section 31595.

"1940 Act Standard of Care" means the standard of care applicable to registered investment advisors who have a fiduciary duty to their investors under the federal Investment Advisors Act of 1940 ("1940 Act").

"Private Market Investment" means an investment strategy, fund, or fund manager SCERS' identifies as venture capital within the Private Equity asset class, or as an energy partnership within the Real Assets asset class.

POLICY

Under Article XVI, Section 17 of the California Constitution, the Board has sole and exclusive fiduciary responsibility over the assets of the system and shall discharge its duties 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 and with like aims. This is often referred to as the "prudent expert rule."

The Board contracts with external investment managers, advisors, and consultants for the investment of system assets and, as the Board's delegates, seeks in its written agreements for investment management and consulting services, to hold these service providers to the same fiduciary standard of care to which the Board itself is subject.

A. Contractual Standards of Care

1. SCERS will include terms for the Preferred Fiduciary Standard of Care In negotiating all of its contracts for investment management and consulting services. It is anticipated all public markets investment managers will agree in writing to this fiduciary standard.
2. In the alternative, SCERS may accept terms specifying the fiduciary standard of care set forth in the 1940 Act for Registered Investment Advisors. It is anticipated that most private market investment managers will be Registered Investment Advisors and subject to the standard of care specified in the 1940 Act.
3. On a case-by-case basis if and as necessary, SCERS may accept an alternative, lower contractual standard of care pursuant to the guidelines and application specified in this Policy. It is anticipated this will arise in connection with private market investments (as defined herein) that typically offer a lower standard of care as the industry standard.

B. Guidelines for Assessing and Accepting a Lower Contractual Standard of Care for Private Market Investments

Rather than simply accept the lower standard of care typically offered in the terms for private market investments, SCERS will attempt to negotiate inclusion of the Preferred Fiduciary Standard in each of its side letters for such investments.

When SCERS is unable to negotiate the Preferred Fiduciary Standard in a side letter for a private market investment, and the private market investment manager represents that it is not a Registered Investment Advisor, SCERS will assess on a case-by-case basis whether to proceed with the investment, and will seek the following in its consideration:

1. Written affirmation from SCERS' Investment Counsel that the private market fund/manager will agree in its side letter with SCERS to provide sufficient transparency and notice regarding any action taken by the fund/manager that would otherwise amount to a conflict of interest or deviation from the fiduciary standard under the 1940 Act for Registered Investment Advisors.
2. Written affirmation from SCERS' alternative assets investment consultant that the consultant has reviewed the investment risks of the private market investment, the risks of private market investments more generally, and the limited fiduciary standard offered by the specific fund/manager, and that based upon the consultant's due diligence, the standard of care offered by the fund/manager is consistent with other similarly situated investment funds/managers who manage institutional assets in similar investment types and strategies.

3. Assessment by SCERS' Staff and consultant of the characteristics, processes and track record of potential private markets investments that will mitigate the risk of a lower standard of care, including:
 - a. A track record of multiple funds performing in the top quartile of its peer group across the cycle.
 - b. Experienced general partners and partners.
 - c. A track record evidencing the fair treatment of limited partners historically (including during stressful times or circumstances when the fund performance has been less than optimal).
 - d. A history and process for dealing with conflicts of interest (such as investing in companies held by prior or successive funds).

C. Investment Protocol

The assessment of the fund terms for standard of care is one important element in a mosaic of factors in determining whether to make or maintain a private market investment. However, since it involves both a quantitative and qualitative evaluation of many factors, flexibility, rather than rigid rules or hard limits, is warranted. This Policy sets forth the considerations that will impact how a conclusion is reached for any specific private market investment opportunity.

The evaluation of the potential risk and risk mitigation of the standard of care provided by a private market investment's fund terms will be incorporated in SCERS' due diligence process and reports that outline the basis for the investment decision.

BACKGROUND

It has been SCERS' practice to hold its investment managers to the same standard of care to which the Board is held. However, this past practice is difficult to maintain as alternative investment managers in general are reluctant to agree to the Preferred Fiduciary Standard of Care. This is an industry wide challenge for public pension plans.

Fortunately, since the Dodd Frank Act, most alternative investment managers are Registered Investment Advisors (RIAs) under the 1940 Act. The 1940 Act fiduciary standard of care requires registered investment advisors to act and to serve a client's best interests with the intent to eliminate, or at least to expose, all potential conflicts of interest which might incline an investment adviser--consciously or unconsciously--to render advice which was not in the best interest of the investment adviser's clients. Among public pension plans nationwide, the fiduciary standard of care required of RIAs by the 1940 Act is generally held to be acceptable.

Unfortunately, private market investments as defined herein are not subject to the Dodd Frank Act, and thus are not RIAs. Instead, these managers present themselves as fiduciaries under Delaware law. The challenge is that under Delaware law, investment

managers can expressly contract with limited partners not to be held to certain fiduciary practices as required by ERISA and the 1940 Act. Such exempted practices include, but are not limited to, allocation of assets among sub-funds and arms-length transactions. To date, public pension plans have had very limited, if any, success in negotiating a higher standard of fiduciary care with these private market investment managers.

Investing in venture capital and private energy partnerships remains an important component in the construction of SCERS private equity portfolio. Venture capital funds provide unique return profiles by investing in higher growth, early stage companies that benefit from developing breakthrough technologies. Investments in these companies helps to provide diversification from more mature companies prevalent in the investments of other private equity strategies such as buyout or distressed debt. Investment in private energy partnerships provides diversification from other private real assets strategies such as infrastructure. Given both the importance of venture capital and private energy partnership investing and factors unique to each fund which can mitigate risk, the guidelines in this Policy highlight the circumstances and assessments that SCERS will undergo for private market investments before agreeing to a lower standard of fiduciary care.

RESPONSIBILITIES

Executive Owner: Chief Investment Officer

POLICY HISTORY

Date	Description
08-01-2018	Renumbered from 041
01-17-2018	Board renamed and amended in revised policy format
01-16-2013	Board approved; Resolution 2013-05