



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

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### Agenda Item 7A

**MEETING DATE:** March 20, 2024

**SUBJECT:** Alternative Asset Investment Standard of Care Policy

**SUBMITTED FOR:**  Consent       Deliberation and Action       Receive and File

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#### **RECOMMENDATION**

Re-affirm Alternative Asset Investment Standard of Care Policy with no amendments.

#### **PURPOSE**

This item supports Strategic Management Plan goals regarding effective oversight of SCERS' investment program and Plan assets.

#### **DISCUSSION**

In March 2021, the Board replaced its existing Fiduciary Standards Policy with the current Alternative Asset Investment Standard of Care Policy, establishing guidelines for SCERS to negotiate an appropriate fiduciary standard of care for investment funds in the Absolute Return, Private Equity, Private Credit, Real Estate and Real Assets asset classes, *i.e.*, Alternative Asset Investments. In June 2023, investment counsel Michael Calabrese reviewed the impact of the policy with the Board and reported that SCERS has been more successful at securing a preferred standard of care in its investment agreements since the policy was adopted.

Pursuant to SCERS' practice of reviewing and refreshing policies every three years, Staff has re-evaluated the policy to consider whether any amendments are necessary due to legal changes or practical experience. Considering the positive impact of the policy in the three years since its adoption, Staff has concluded that no amendments are necessary at this time.

#### **ATTACHMENTS**

- Board Order
- Alternative Asset Investment Standard of Care Policy

Prepared by:

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Jason R. Morrish  
General Counsel

Reviewed by:

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Eric Stern  
Chief Executive Officer



# Retirement Board Order

## Sacramento County Employees' Retirement System

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**Before the Board of Retirement  
March 20, 2024**

AGENDA ITEM:

### **Alternative Asset Investment Standard of Care Policy**

THE BOARD OF RETIREMENT hereby accepts the recommendation of Staff to re-affirm the Alternative Asset Investment Standard of Care Policy with no amendments.

I HEREBY CERTIFY that the above order was passed and adopted on March 20, 2024 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

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James Diepenbrock  
Board President

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Eric Stern  
Chief Executive Officer and  
Board Secretary



# ALTERNATIVE ASSET INVESTMENT STANDARD OF CARE POLICY

## PURPOSE

The purpose of this policy is to require that Alternative Asset Investment fund managers and general partners agree to a fiduciary duty of care when entering into an investment contract with SCERS. A further purpose of this policy is to set forth the narrow circumstances in which it is permissible for such contracts to contain a different duty of care.

## DEFINITIONS

As used in this policy, the term “Alternative Asset Investment” shall mean an investment strategy, fund, or fund manager SCERS identifies as Absolute Return (Hedge Funds), Private Equity (including venture capital), Private Credit, Real Estate, or Real Assets.

## POLICY

### A. Contractual Fiduciary Duty of Care

In entering into an Alternative Asset Investment contract as a limited partner or similar capacity (including, but not limited to, side letters with fund managers and general partners), SCERS shall require anyone who exercises investment discretion over system assets to be subject to the same duty of care to which the Board and staff are subject. Such a duty of care shall be contractual in nature and enforceable by a private right of action by SCERS.

California law calls for the Board and staff to discharge their 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.” Cal. Const. Art. XVI, § 17; Gov. Code § 31595. Accordingly, SCERS’ Alternative Asset Investment contracts shall include a provision setting out an actionable, contractual fiduciary standard of care, similar to the following:

*Each of Manager and the General Partner agrees that it and any person acting on its behalf under the Partnership Agreement owe fiduciary duties to all Limited Partners in accordance with applicable law governing the Partnership. As such, each of the General Partner and the Manager agrees that it will act in good faith in the best interests of the Partnership and the Limited Partners 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 a like character and with like aims, will not place its interests above the interests of the Limited Partners, and with respect*

*to all investment opportunities and investment allocation decisions, will allocate such opportunities among the Limited Partners and the entities managed by the General Partner, the Manager and its Affiliates on a fair and equitable basis and consistent with its duty of loyalty to the Partnership and the Investor with respect to its investment in the Partnership. Each of Manager and the General Partner acknowledges the applicability of Article XVI, Section 17 of the California Constitution and Government Code Section 31595(b) to the Investor's investment in the Partnership.*

In addition, SCERS' Alternative Asset Investment contracts shall include a provision designating Sacramento County or the Eastern District of California as the jurisdiction and venue for any dispute regarding such standard of care.

## **B. Other Standards of Care**

Experience has shown that, in negotiating Alternative Asset Investment contracts, some fund managers and general partners refuse to agree to a prudent expert or fiduciary duty of care, or to a Sacramento-based venue and jurisdiction. Experience has also shown that such fund managers and general partners may insist on a lower or non-actionable standard of care. For example:

- A fiduciary duty of care diluted by an exculpation clause (i.e., a separate clause releasing various causes of action against the general partner or manager);
- Where the general partner or manager is a Registered Investment Adviser with the Securities and Exchange Commission, a non-contractual "acknowledgement" that it is registered and therefore subject to the regulator-enforced fiduciary standards applicable to registered advisers under the Investment Advisers Act of 1940;
- Where the general partner or fund manager is not a registered investment adviser (e.g., in connection with a venture capital fund within the Private Equity asset class, or an energy partnership within the Real Assets asset class), no acknowledgment of a duty of care at all.
- Where the fund is based in Delaware, a fiduciary duty of care under Delaware law, but actionable only by the collective limited partnership and diluted by modifications and waivers (which are permissible under Delaware law);
- Where the fund, general partner, or manager is based outside the United States, a contractual or non-contractual acknowledgment that they will comply with the duty of care as required by the laws of their local jurisdiction.

Such standard of care terms, and a non-Sacramento jurisdiction/venue, are highly disfavored, as SCERS expects its investment delegates to be willing and accountable fiduciaries to SCERS. Nevertheless, and notwithstanding the foregoing Section A, SCERS may in rare circumstances accept such disfavored terms if staff complies with Section C.

### C. Mandatory Protective Steps

In connection with any Alternative Asset Investment contract in which SCERS accepts a standard of care similar to those identified in Section B, or a non-Sacramento jurisdiction/venue in connection with standard of care disputes, staff shall take all of the following steps:

Importance to SCERS' Strategic Asset Allocation: Staff shall create a written record that:

- The at-issue Alternative Asset Investment belongs to an asset class of investments (with reference to sub-asset class, geography, strategy, and/or sector) that is important for SCERS to invest in in order to implement the alternative asset investment strategy under the Master Investment Policy Statement and the Growth/Diversifying/Real Return/Opportunities Investment Policies;
- The at-issue Alternative Asset Investment would play an important role in helping SCERS meet the investment objectives of that asset class;
- A written opinion from investment counsel, which may be based on general experience and familiarity with the market and industry, that:
  - SCERS would be unlikely to obtain better terms on the duty of care from similar funds (e.g., funds that would serve a function within SCERS' alternative asset investment strategy similar to the one identified above); and
  - Further negotiations are unlikely to yield a better duty of care term for that particular Alternative Asset Investment.
- A written opinion from SCERS' investment consultant explaining why the at-issue Alternative Asset Investment is important to (1) implementing the strategy set forth in the applicable asset class investment policies, including with respect to sub-asset class, geography, strategy, and/or sector, and (2) meeting the investment objectives of the asset class where the at-issue investment will reside.

Compensating Factors: Second, staff, with written input from investment consultants, shall assess whether the at-issue Alternative Asset Investment can demonstrate the ethical governance and likely performance that would proportionately compensate for the lower standard of care. Specifically, staff shall obtain written opinions from its consultant, including:

- Whether there is a track record of strong performance relative to the fund manager's or general partner's targets, and relative to peer funds;
- The experience of key persons associated with general partners and fund managers;

- 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;
- A history and process for dealing with conflicts of interest (such as investing in companies held by prior or successive funds); and/or
- Other factors bearing on ethical governance and future performance.

Transparency and Notice: Third, staff shall obtain a written confirmation from investment counsel that, as a part of the investment contract or side letter, the general partner and/or fund manager have agreed to provide transparency and notice regarding any action they take that would amount to a conflict of interest or a deviation from the fiduciary standard for Registered Investment Advisers under the 1940 Act.

Periodic Global Review: Fourth, staff shall periodically engage investment counsel to review its Alternative Asset Investment portfolio and confirm that SCERS’ overall record with respect to duty of care negotiations meets or exceeds the industry norms and the prudent expert standard. In addition, staff shall obtain and implement advice from such counsel with regard to market trends and whether SCERS has become “over-weighted” in sub-optimal negotiated standards of care.

**BACKGROUND**

When SCERS enters into an Alternative Asset Investment, fund managers and general partners acquire investment discretion over system assets and effectively become delegates of the Board. When negotiating side letters, SCERS always seeks to hold such delegates contractually responsible for the same duty of care to which the Board is bound. Experience has shown that SCERS’ success in negotiating for that term can turn on sheer market supply and demand.

This policy continues SCERS’ historical custom, practice, and policy of requiring Alternative Asset Investment fund managers and/or general partners to agree to a fiduciary standard of care. This policy also sets forth narrow circumstances in which SCERS may accept a lower standard, and the analytical and evidentiary record that staff must create before accepting such a standard.

**RESPONSIBILITIES**

Executive Owner: General Counsel

**POLICY HISTORY**

Date	Description
03-20-2024	Board re-affirmed policy
03-17-2021	Board approved new policy to replace Fiduciary Standard Policy
08-01-2018	Renumbered from Policy No. 041

01-17-2018	Board renamed and amended in revised policy format
01-16-2013	Board approved Resolution 2013-05